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BOOK REVIEWS

Principles of Accounting, Intermediate
(Fourth Edition)

By H. A. Finney and Herbert E. Miller. PRENTICE-HALL, INC., New York, N. Y., 1951. Pages: xiii + 975; $7.65.

The fourth revision of this standard work on Intermediate Accounting attempts, in the words of the authors, to accomplish the following: (1) Lead the student up a somewhat gentler slope from the Introductory level; (2) Obtain a better distribution of material between the Intermediate and Advanced volumes; (3) Broaden the base of the students' knowledge of subjects which are in the transitional or controversial stage; and (4) Deal adequately with new developments in accounting theory and practice.

With these objectives in view, Chapter 1 reviews and summarizes briefly the major principles and procedures contained in the text on elementary accounting. The following four chapters discuss and demonstrate the required closing, adjusting and reversal entries, as well as the preparation of working sheets and financial statements for both merchandising and manufacturing concerns. Detailed treatment is given to various types of errors which may occur at the close of the fiscal year, the extent to which financial statements can become distorted by the understatement or overstatement of income, expenses and net worth, and the retroactive adjustments required to correct such errors. This in turn is followed by four chapters on comparative statements and percentage analysis.

The chapters on partnerships included in the former editions are omitted and moved to the advanced text so as to place more emphasis on corporation accounting in this Intermediate course. Similarly, all matters relating to compound interest and annuities were transferred to the advanced text, except that amortization of bond premium and discount are dealt with in this Intermediate text on a straight line basis.

Particular attention is directed to such subjects as the clean surplus theory, inventory pricing, depreciation in periods of inflation, new concepts of current assets and liabilities, pensions, buy-build-sell-lease transactions, application of LIFO to the retail inventory procedure and proposed changes in accounting terminology. Both sides of controversial subjects are presented with frequent references to the official pronouncements of the Securities and Exchange Commission and the American Institute of Accountants. Problem material and review questions are well-keyed to the text material.

As in the case of previous editions, this book is excellently suited for classroom as well as self-instruction.

B. BERNARD GREIDINGER
Graduate School of Business Administration
New York University, N. Y.

Accounting Systems: Procedures and Methods

By Cecil Gillespie. PRENTICE-HALL, INC., New York, N. Y., 1951. Pages: xli + 811; $8.65.

This volume is worthy of careful study by any practitioner desirous of increasing his value to his clients and of augmenting his fees.

In view of the fact that systematizing provides so many wonderful opportunities to render valuable assistance to clients, it is remarkable that comparatively few certified public accountants have devoted the time and research necessary to develop themselves in this area of professional service. One deplorable result of this neglect is that systems assignments all too frequently go by default to men who are neither qualified nor subject to professional restraints.

The accountant who wishes to increase his competence in the field of systems, procedures, and methods is advised to obtain this book, whether he be an experienced systematizer or a neophyte. Even aside from systems assignments, it is likely that a man will be a better auditor as a result of his systems knowledge, in that it will abet him in the detection of weaknesses in the internal control.

This book provides a far more comprehensive coverage of the techniques and knowledge required for this type of assignment than has heretofore been available. As such, it fills a gap in the literature of accounting. The style is readable. It has the merit of being exhaustive without being exhausting, and of being sound without being stuffy. The approach is practical and specific. Thoughts are developed in logical sequence, using the proved pedagogical principle of moving from the known to the unknown, and from the simple to the complex. Among other features, it contains the most comprehensive coverage of mechanized accounting since Schnackel and Lang published their book in 1929.

The scope of the book is comprehensive indeed. Three chapters are devoted to surveys, charts, and worksheets used in the field of systems and procedures work. The only deficiency in this part of the book noted by the reviewer is the absence of any mention

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BOOK REVIEWS

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of the highly useful Work Distribution Chart.

There are two chapters on the classification of accounts for different types of businesses, and a chapter on codes. Three chapters on journalizing and posting describe basic plans of journal form and ledger structure. This includes a discussion of "ledgerless bookkeeping" as well as the more conventional plans. The section is profusely illustrated with ready printed forms available from the large stationery printing concerns, as well as forms specially designed to meet individual situations. There are brief chapters on forms design and on internal control.

The subject of "Accounting for Small Business" is accorded two chapters, which should prove interesting to every accountant with clients in this category.

The section of the book which is captioned "Methods" contains four excellent chapters on machines and equipment.

There are fourteen chapters on systems including order billing, accounts receivable, accounts payable, payroll, inventory, etc. In addition to the very comprehensive coverage accorded to the various systems, each chapter in this section contains a check-list of points to consider in systems design. This feature will prove particularly valuable for the experienced systematizer.

There is one chapter on reports and manuals, and four chapters deal with punched card accounting.

This highly abbreviated summary of the contents is provided to indicate the breadth of the book. It is written by an accountant for accountants. It is no mere compendium of office techniques and short-cuts, however worthwhile such volumes may be. The author concerns himself first with what accounting information is necessary to conduct a business and to make wise decisions. Then he addresses himself to the manner of determining the most efficient method of arriving at the desired result. The sense of perspective is admirable.

Having extolled the merits of the book, it is appropriate to mention some important omissions. The book is silent on the entire topic of the application of electronics to accounting, which is noteworthy in view of the 1951 copyright date. There is no mention of the Work Simplification approach to methods improvement, whereby all key personnel are instructed in the basic principles, and are encouraged to participate in improving the operations of their own sections.

Most regrettable is the omission of any consideration of the human relations problems of systematizing other than a parenthetical remark that a systems man must be a good salesman. When one considers the vast number of systems installations which failed because of faulty human relations rather than any technical defect in the system, one can only hope that subsequent editions of the book will offer guidance in this difficult area of systems work.

Notwithstanding the last few remarks, this book is a meritorious one, and will earn a place on the desk-top library of many busy accountants.

MICHAEL A. C. HUME

Chairman, Committee on Accounting Machinery
The New York State Society of CPA's.

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BOOK REVIEWS

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Price Controls

By Dr. Julius Hirsch and William J. Casey. BUSINESS REPORTS, INC., New York, N. Y., 1951. Pages: 193; $12.50.

To the confused and troublesome field of price stabilization the authors of this book —which is described as a policy manual— attempt to bring some measure of clarity and comprehension. Avoiding the pitfalls attendant upon analysis of specific regulations, they seek rather to give the reader a background and understanding of the theories and philosophy of price control so that he may resolve his particular problems in a manner consistent with the intent of the law and applicable price orders.

A summary of what the manual seeks to accomplish is found in the following paragraph taken from the introductory material on the first page:

> "* * * this manual will not undertake to spell out exactly how each seller can determine the ceiling price for each product. Rather, it will undertake something more fundamental—to give businessmen and their professional advisers the perspective necessary to live with price control, to adapt to its requirements and to develop the adjustments which are constantly necessary. The regulations of general applicability are analyzed. There are working aids to applying the general manufacturers' order, the orders which apply to retailers and foreign traders. There is advice on the adaptation of accounting records to give the information necessary to price properly, to seek adjustment and to demonstrate compliance. There is analysis of the impact of price control on trade practices and recommendations on what can and can not be done in modifying cash and quantity discounts, credit terms, service and trade-in features, etc."

The authors have drawn heavily upon experience under O.P.A. and have interpreted current controls in the light of such historical background. This they are well qualified to do. Dr. Hirsch was chief economic consultant to O.P.A. in World War II and is author of "Price Control in the War Economy" and "Standard Figures for Industry." Mr. Casey, who is a member of the New York bar, has written extensively on price controls while associated with the Research Institute of America.

The manual is presented in a three-ring looseleaf binder to permit removal and replacement of its worksheet and insert sections. Among those sections are worksheets

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BOOK REVIEWS

(Continued from page 526)

for manufacturers under CPR 22 and a section on how to use industrial figures and economic data and how to get price and other economic data on specific industries in seeking relief from oppressive regulations. There is also presented a specimen petition for relief from hardship.

At the present writing the question of price stabilization is in a state of flux. Whatever course Congress may take it is likely that businessmen and their advisers will find the manual a helpful reference on the subject.

LEONARD PRICE

New York, N. Y.

New York Laws Affecting Business Corporations (Annotated)

32nd Edition, Revised to April 16, 1951. 667 pages. Price: $2.50, postage prepaid. UNITED STATES CORPORATION COMPANY, Albany, N. Y.

This handy volume contains the Business Corporations Law, the General Corporation Law, the Stock Corporation Law, the Membership Corporation Law, and numerous articles and sections of other chapters of the Consolidated Laws, relating to business corporations. There is also included a synoptic analysis (which provides quick reference to the several corporation laws), a table of cases, and a complete index.

The most important changes reflected in this edition affect paragraphs 9, 40, 51, and 65 of the Stock Corporation Law; paragraphs 194, 197, 211, 217 and 366 of the Tax Law; and paragraph 21 of the Personal Property Law.

Survey of New York Law (1949-1950)

Contained in the December, 1950, issue of the New York University LAW QUARTERLY REVIEW. (Volume 25, Number 5.) New York, N. Y.; pp. 955-1304, inclusive. Three dollars for this issue; five dollars per year.

This is the fourth volume in the annual series surveying New York law. The work is now divided into five parts:

1. Public Law: In General
2. Commercial Law
3. Property Law
4. Equity, Torts and Persons
5. Adjective Law.

This reviewer believes that the sections dealing with State and Local Taxation, Trusts and Administration, and The Law of Succession will be of particular interest to practicing accountants. Likewise, the part dealing with Commercial Law will undoubtedly prove helpful.

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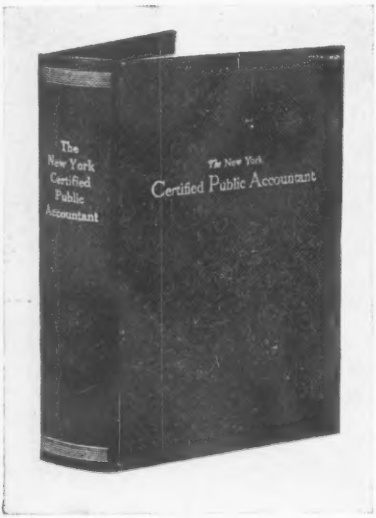

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EMANUEL SAXE, *Managing Editor*

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VOL. XXI *August • 1951* No. 8

How to Prepare for the Auditor

By THOMAS H. CARROLL, C.P.A.

Why Prepare?

I think the first question that we ought to decide in considering answers to the question under consideration is "why"?—that is, why prepare at all? To give an overly simplified answer is easy. The client saves time and thus dollars. Surely this alone is a compelling reason, but by way of additional values he gets a better job, better answers, and faster results. This is not an idle assertion, which will become clearer as we investigate further.

Like many other similar situations, this is not a one-way street for the auditor also benefits. It is always annoying to the professional auditor to consume time in doing copy work, hunting for vouchers unnecessarily, waiting for records, etc. That is fruitless both to the auditor and to the client, and the hours and days accumulate to little useful purpose. The auditor hates to bill such sterile time and he is annoyed by the waste and the needless trouble trying to demonstrate that such waste is not his fault and that the client should pay for it.

THOMAS HOLBROOK CARROLL, C.P.A., has been a member of the Pennsylvania Institute of Certified Accountants since 1935, and a member of the National Association of Cost Accountants.

Mr. Carroll was graduated from the University of Pennsylvania in 1927 with the degree of B.S. in Economics.

Mr. Carroll is a partner of Peat, Marwick, Mitchell & Co., resident in Philadelphia.

When to Prepare

To go on from there, perhaps we might consider the "when" of this preparation. I think the advantages of doing work preliminary to the end of the client's fiscal year cannot be overlooked. In the course of such work it is likely that matters can be brought up for decision and for solution prior to the end of the year, after which it might well be too late to find a sufficient remedy for perhaps an annoying lapse on someone's part. Unsound tax policies may be foreseen if sufficient time is available to investigate and to correct or amend what are often merely inadvertent mistakes or omissions. Problems that may be new, such as those arising from the operation of pension plans, can be foreseen and handled in such a way as to preclude damaging notations to be included in published reports. Renegotiation is another resurgent problem to which some forethought may be profitably given. Omissions of proper approvals of capital expenditures or of salary increases or borrowings can be corrected before the end of the fiscal year, and the seriousness of violations

of by-laws or of management operating procedures can be corrected.

Legal opinions can often be obtained before it is too late on matters of doubtful propriety or doubtful legality, and thus the whole problem of needlessly improper presentation averted. Housecleaning of records can be done more completely and in a timely fashion if the signs of dust and dirt can be found within available time to correct. One of the things that often comes to our attention is the matter of violations of indenture provisions, which have, through inadvertence, escaped the eagle eye of the company's accountants—perhaps because internal pressures could not have been foreseen or foresworn. If these same conditions are ascertained only after the close of the year, it sometimes results in an embarrassing necessity to approach the trustee under, for example, a note issue in order to gain his retroactive approval of something that should not have been retrospective. A recent case which comes to my mind arose through the operation of a bonus plan in which officers' salaries, when combined with bonus, exceeded the limitations contained in an indenture under a note issue. Had this been foreseen, it would not have been necessary to go to the trustee and ask for remission of a clear-cut violation of the indenture.

What to Prepare

Some of the things that can be done to assist the auditor greatly, and with clear benefits to the client, are these:

1. Detailed analyses of lists of additions to capital assets, accompanied by properly arranged original invoices. In this case there should be agreement between the auditor and the client as to the arrangement of the detailed data in columnar form, the extent of description required, organization of lists by sub-account classification, etc.

2. Similarly as to the analyses of capital assets disposed of or transferred. Here, of course, invoices are not the important thing, but rather proper authorizations for disposal or transfer should be available and information should be keyed so that items can be traced into the plant ledger.

3. The next logical thing, of course, is a summary of capital assets and allowances for depreciation, showing all changes which may have occurred during the period under examination.

4. One of the most useful things that the auditor can find prepared for him is a list of aged accounts receivable. This, of course, can take the over-all form or merely the form of those over a certain age.

5. Tapes of all ledgers as of a selected date should be preserved for eventual checking by the auditor.

6. Detailed schedules can be prepared of such items as miscellaneous administrative expenses, maintenance of equipment and buildings accounts, taxes, legal expenses, bad debt expenses, scrap expense and income, interest income, officers' salaries, and similar other accounts. These are matters which the auditor nearly always wants to investigate. He can make such check of them as the circumstances seem to require.

7. Detailed inventory instructions should be prepared and the auditor should have the opportunity to approve them in advance of issue to the branches or to the departments within the plant being examined. This refers largely to the physical count and observation. Pricing of inventories is, of course, a rather different problem and one which is more apt to be dealt with at the year-end rather than during preliminary work. If possible, schedules should be prepared based upon the methods of accounting in use; that is to say, actual costs or standard costs, and in any case detailed schedules can be prepared to show differences between actual and standard and an analysis of variance accounts. Burden rate calculations should be submitted in sufficient detail for the auditor to make proper

check. There is infrequently trouble with raw materials and, of course, there is increasing complexity with finished stock and work-in-process. We all know that finished stock should be supported by detailed schedules for purposes of pricing, and we know that work-in-process should be accompanied by work orders in process or by properly certificated copies thereof.

To the extent possible, these detailed schedules should be supported with source material or with a list of sources from which market values can be compared with carrying values.

8. Detailed work sheets showing accumulation and liability for property and social security taxes can easily be prepared to the interim date and subsequently carried on to the year-end. They can later be checked against social security records and to returns actually filed when the auditor shall return for his year-end final work.

Perhaps at this point it might be well to say that all of these schedules and working papers should be prepared to a maximum degree on working paper to be provided by the auditors. In some cases it is possible for the internal accountant merely to make copies of his own analyses throughout the year and to turn these copies over to the auditor at the time of his visitation.

9. It is always an excellent thing to prepare copies of bank reconciliations for the auditor's use and oftentimes clients will prepare requests to banks for confirmation of the bank balances.

10. Lists of marketable securities, if a substantial number of items are held, together with numbers of certificates, will save considerable copy time by the auditor and will tremendously assist in actually counting the securities at the safe deposit box on the year-end. Location of such securities should also be shown, particularly if pledged for collateral or otherwise deposited. Accrued interest and dividends should also be shown.

11. Almost all well-run companies maintain good schedules of insurance coverages, which also show the unexpired part of the premium. In some cases these schedules may be summarized to a substantial degree and the auditor can then check them directly to the insurance register maintained by the client. Part and parcel of this procedure is the writing of letters to life insurance companies to secure authentication of cash surrender values as of the end of the fiscal year. As a rule the insuring company should be asked to send the original answer directly to the client with a copy going to the auditor.

12. One of the items which causes eternal sweating to auditors is the reconciliation of inter-company and interplant balances. I have never known an auditor who did not have continual trouble with this item. It is due, of course, to late remittances or failure to clear promptly items otherwise in transit or in dispute. The alert internal accountant can usually prevent these occurrences by keeping the records clear just prior to the audit date.

Incidentally, one of the many advantages of doing preliminary work is the fact that errors are discovered first by the internal organization and thus embarrassment to all concerned is minimized. Although almost any reasonably mature person will feel disgrace at having changes made by auditors, it nevertheless serves to minimize unintentional lapses and the nuisances of having figures already circulated changed.

While this is something of a digression from the sort of thing we have been talking about, it might well serve to interpose a different kind of thinking with which the auditor himself should be cognizant. There is a very present danger that there might be a tendency toward too great reliance on accuracy of the client and his employees, and I think where this practice has been adopted on a wide-spread basis the auditor must be especially careful to maintain rigid thinking and acting, and he should impress this on his assistants or associates in the course of the work.

How to Prepare

Another kind of digression may well fit at this point, and that is that the client and the auditor can both do a great deal to expedite the work in other ways. We are talking now largely about how the client should prepare for the auditor, so my remarks are directed mainly toward you, the client. I think a good psychological set up should be organized by responsible personnel which will accomplish two main things: (1) that the more pleasant and the more cooperative the attitude of the employees can be made toward the auditor, the better off all concerned, and (2) that in reality the auditor is there for the specific purpose to report on the fairness of presentation by the company. It does not help if the employees or the controller himself adopts an antagonistic attitude. I think instead he would accomplish more if he were to adopt a helpful and informative approach in presenting the problems he will almost surely have to face and discuss. Antagonism simply does not pay off, and I urge all of you to develop that spirit of cooperation among your own staff.

While indirectly the auditor also loses something from an improper attitude, the client, it seems to me, loses much more. I hate to make so bald a statement, but I do believe that good relations between the staff of the client and the staff of the auditor can account for a swing of 50% from the proper norm of hours on the engagement. To explain that further, excellent cooperation can result in a less than normal expectancy of perhaps 10% to 15%, and the lack of cooperation can result in a deviation from normal of from 25% to 35% in an unfavorable direction. This is your problem just as much as it is the auditors, and I think even more so since time is money and you are going to have to pay for it in the end.

The actual arrangements with the auditor, financial and otherwise, ought to be made early in the year. In that way the auditor is enabled to settle his staff commitments properly to maximum advantage to the client and to himself. Then too, there can be a clear understanding with the internal accounting officials who can consult with the firm already engaged as to problems as they occur, and unfortunately recur throughout the year. Mistakes, arguments and in general all kinds of disagreeable little items are so minimized as to make the audit a pleasure rather than a chore. From all points of view it is advantageous to do preliminary work since the more clerical routine work that is done by the client, the more time is available, within the fee, for the auditor to audit. The result of all this is that both the company and the client feel they are paying for the skilled professional services of trained personnel instead of for a lot of needless copy work on the part of obviously semi-trained young men. The auditor, on the other hand, feels that he is justified in charging reasonable per diem rates for services that the client could not otherwise obtain. There exists a feeling of efficiency and of satisfaction on the part of both the client and the auditor that satisfactory results have been obtained.

There are a few other items that are often overlooked but which can be beneficially adopted. For instance, some of our clients automatically make copies of minutes of the Board of Directors', Finance Committee's, and/or Executive Committee's meetings, which are sent to us throughout the year. In other cases these copies are accumulated and handed to us at the time of our visitations.

Although not so frequently done, there are two other items which I think should be done. One is that I think the client should obtain a complete and clear statement of the existence of any contingencies which may be known to corporate counsel, and the other is that I think the client should supply an accurate and supported list of commitments in the future. This has to do, of

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Public Relations and Professional Responsibility

By COLIN PARK, C.P.A.

DURING the past few years, the public relations programs of the national and state societies of accountants have been expanded greatly. Through the publication of clear and concise information, the dissemination of interesting broadcasts, and other means, our representatives at the professional-organization level have taken the lead in attempting to create favorable public attitudes and greater understanding of the usefulness of accountants' services. As a result of these efforts, we are coming to recognize the enormous importance which subtle shifts in public opinion[1] can have upon the professional practice of accountancy. Admittedly, the extent of the effect of public opinion upon accountancy practice is difficult to measure. Nevertheless, we are aware of the fact that the profession could not grow in its usefulness to the national community without the public's confidence in the validity of our dedication to high technical and ethical standards.

COLIN PARK, M.B.A., C.P.A., is Assistant Professor of Accounting in the School of Business Administration of The University of Buffalo. He is a member of our Society and is also a member of the American Institute of Accountants and the American Accounting Association.

It is a recognized public relations procedure that influencing the public along certain lines is not a matter of hitting the whole target with buckshot, trying as it were to reach all interested groups in one concerted, all-purpose blast of publicity. Rather, the accomplishment of over-all group approval involves hitting individual target-publics by separate shots from different angles.[2] Part of the purpose of this discussion is to point out that practicing accountants themselves represent the most important initial target-public, for the reason that our success as a professional group depends chiefly upon the actions of individual members. In short, if we are to achieve an effective public relations program, it must be based upon enthusiastic understanding and support at the common denominator of the general membership.[3] Official pronouncements and skillfully-devised top-level publicity cannot succeed alone. Therefore, before we seek to convince others as to the astuteness of our present and ultimate objectives, we should convince *ourselves.* This calls for honest analysis of our objectives and for a re-estimation of how our further progress as a profession may best be achieved.

The decision to expend considerable time and money in informing common-interest groupings of persons outside of our profession can be inferred as having been arrived at from two valid

[1] *Public Opinion and The Accounting Profession,* (New York: American Institute of Accountants, 1950), p. 1.

[2] Cf. J. Handley Wright and Byron H. Christian, *Public Relations in Management,* (New York: McGraw-Hill Book Company, Inc., 1949), p. 18.

[3] As reported in "Wide Variety of Technical and Professional Matters Discussed at Institute Annual Meeting", *The Journal of Accountancy,* November, 1950, Vol. 90, No. 5, p. 425; Mr. Clifford C. Beasley, Managing Director, Florida Institute of Accountants, said: "The stimulation of favorable acceptance of one's profession by a second party is not necessarily dependent upon numerical strength. Large or small, the success of a (public relations) program depends on interested participation by those to whom the benefits will accrue."

points of view, neither of which is selfishly materialistic. The first of these is the sensing that by this means it may be possible to enhance the effect of the public interest upon accountancy practice. The second has to do with the belief that through well planned public relations the direction of the profession's progress may become more clearly defined. These motives are interrelated, since continuing improvement in professional regard for the public interest implies progress. Conversely, progress cannot be achieved without effective approval which stems from the public's conviction that its interests are the primary concern of accountancy. The profession claims to have this primary concern for the protection of the public interest.[4] Therefore, if the members of an organization do not adjust their technics with sufficient speed to suit the ever-changing times, the organized activity may be curtailed or repudiated and eventually replaced. Consequently, the success of a professional group may be measured by the ability of its rank and file as well as of its leaders. All members must be able to think and plan in terms of the future. We must be able to forecast the demands of the future and be ready for that inevitable time when the abstract problems of today become realities.

According to one authority, effective "public relations consists of doing the right thing and letting the public know what you are doing."[5] Progress in the positive sense certainly implies "doing the right thing" in coping with the pressing problems of the present, but it also suggests the necessity for visualizing the challenges of the future and preparing for them. This involves a very important decision, for by consuming a share of present productive time and effort to lay the groundwork for tomorrow, less time is available for the work responsibilities of today. We must set our standards for advancement, and in so doing decide just how much progress we can *afford*. We cannot hope to estimate with complete accuracy the extent of present sacrifices requisite to achievement of future objectives. However, is it not possible that the destiny of a professional group can be molded in advance so that achievements when actually realized, can exceed what otherwise might evolve simply by accident, or which perhaps might unfold slowly from precedent? It follows that the fundamental idea is that creative, positive planning for expansion of the usefulness of our professional services must be a conscious procedure. There should be less reliance on ingrained custom and usage, and more attention given to recognition of changes and improvements necessary to meet challenges of the future. Such a forward-looking attitude on our part is an indispensable factor in our public relations.

In terms of progress, public relations of the accounting profession must be regarded as a foresighted, dynamic procedure. Far more than mere publicity activity, it requires shrewd interpretation by all active practitioners, of how the profession can meet more fully the needs of society. This should become more than a theoretical concept in this turbulent twentieth century, for our free, competitive way of life depends upon innovation for its vitality. Surely, the accounting profession in this country has as great a stake in surmounting the present difficult situation as any other group. Moreover, the national community has a right to expect certain things of the accountants, much more than accountancy's cautious conservatism yields, and more than can result

[4] John L. Carey, *Professional Ethics of Public Accounting*, (New York: American Institute of Accountants, 1946), p. 2. See also "The Accountant's Ability To Serve The Public Is in Direct Ratio To The Public's Confidence in The Accountant" by Raymond D. Willard, CPA (in an article in The Bulletin of The Massachusetts Society of CPA's), quoted in *The Journal of Accountancy, May, 1951*, Vol. 91, No. 5, p. 689.

[5] Frank M. Surface, "Controllership and Public Relations", in *Controllership in Modern Management*, Thornton F. Bradshaw and Charles C. Hull, eds., (Chicago: Richard D. Irwin, Inc., 1949) p. 207.

from narrow restriction of public accounting services in their present scope.[6]

The American public regards accountants as wizards in the interpretation of economic activity. But we realize that the process of matching costs and revenues to determine enterprise profit is not the perfect technic others assume it to be. The faith frequently placed in our profession by the layman in his "too ready acceptance of accounting and financial reports as statements of exact and definite fact"[7] is somewhat frightening. Although we recognize the limitations of accounting methodology, since it requires the exercise of considerable judgment and the injection of opinion into the subject matter of financial statements, others are not aware of these restrictions. Consequently, part of our public relations effort should be to explain such limitations to interested publics, and to do it in non-technical language.[8] If this information were accompanied by a forthright outlining of our further plans to improve our technical methods of determining enterprise profit, it would seem that a deeper, more enduring faith in the usefulness of our services could be fostered. Concurrently, by this approach we can reassess and reconceive our unrealized potentialities.

In order to maintain and fulfill the respect of the public in the validity of accountants' findings, the breadth of our professional methodology should reach out beyond its present legalistic confines. We should intensify our efforts to approximate more clearly fundamental economic principles in financial statements, not simply at the leadership or research level, but also at the level of the average working accountant.[9] Our analyses of enterprise financial condition and operating results should reflect an understanding of business cycle theory. Furthermore, since accountants' judgments cannot be based upon examination of every detail of a given problem, we should increase our working knowledge of statistical theory and procedure. Lastly, it is our social responsibility to harmonize our objectives with the challenge which faces the free, competitive economy Americans are striving to preserve and extend.[10] Not only must financial reporting reach closer to economic fact, it must become more readable and interesting if it is to be the basis for clearer understanding of the benefits yielded by the American system of business.

It is easy to rely on the comfortable, established ways of the past, but it can be fatal to discount the possible substance of the future. Some of our future problems are clearly evident today. Other unsolved questions are already pressing, yet *concerted* activity on the part of accountants to surmount the issues seems to be lacking. For example, inflation and the high cost of living are daily topics of conversation of great concern to the man on the street. He thinks and talks in terms of the purchasing power of his dollar, but we accountants continue to report economic activity in historical-cost dollars. These are two different *dialects* which are progressively developing into mutually untranslatable *languages!* It seems to follow that accountants have a primary responsibility to work out and put to practical use a system of finan-

[6] Cf. Samuel J. Broad, "The Need for Continuing Change in Accounting Principles and Practices", *The Journal of Accountancy*, November, 1950, Vol. 90, No. 5, pp. 405-13.

[7] David R. Anderson, *Practical Controllership*, (Chicago: Richard D. Irwin, Inc., 1949), p. 125.

[8] Cf. Charles E. Wilson, "My Brief for Business", *Coronet*, November, 1949, Vol. 27, No. 1, p. 33.

[9] For an example of what is being accomplished at the leadership and research level, see Sidney S. Alexander et al., *Five Monographs on Business Income*, (New York: American Institute of Accountants, 1950).

[10] Cf. "President's Message" by Maurice E. Peloubet, President of the New York State Society of Certified Public Accountants, *The New York Certified Public Accountant*, February, 1951, Vol. XXI, No. 2, p. 81.

cial reporting which would utilize statistical methods for the conversion of historical accounting figures into purchasing-power figures. Considerable basic research has been done in this field.[11] It is up to practicing accountants to have the daring and ingenuity to encourage and develop this innovation further. Of course, along with the introduction of any dollar-conversion technic, the public should be told of its limitations. The possibilities of using it for the improvement of financial reporting can be argued as well. If public opinion is to be aroused effectively, this is one area in which public relations activities of the accounting profession must of necessity deal with plans and aspirations rather than with present accomplishments.

Our public relations program has as one of its goals the advancement of the whole accountancy profession in all its possible spheres of action. Yet a majority of public accountants are preoccupied solely with the auditing function, and this evinces how we fall short of the over-all goal, thus forestalling the natural development expected of the profession. Public relations can pave the way toward advancement beyond present narrow limitations, but this can be achieved only after accountants reconsider their responsibilities and opportunities.[12]

Apparently the average citizen does not realize the limitations of the array of services generally offered by certified public accountants, and this is testimony to the fact that he expects far more from us than we usually provide. As an analogy, let us consider a hypothetical medical profession which renders only the service of diagnosing and treating existing illnesses. In such a case surely the public would clamor for the development of preventive medicine. Yet the findings of the public accountant often constitute simply a scientific determination of business difficulties, and the diagnosis is not always followed by prescription for treatment. The patient is left to find his own cure! If the public is to regard professional accountants as *business doctors*, certified public accountants must spend more time in developing sound businesses, the *preventive medicine* of accounting. Moreover, business diagnoses (that is, audits) should be followed up with detailed suggestions for managerial action, thus helping to eliminate inefficiencies and unsound financial practices. This should be a regular, formalized procedure; the accountant should not wait to be asked. Many businessmen feel that independent audits are a "necessary evil", and this view is not always unjustified. Too often we fail to provide the clincher: written evidence of our desire to help a business improve; constructive criticism designed to contribute positively toward the solving of vital managerial problems.

There are many aspects of current accounting methodology which are appropriate to public relations treatment when tied-in with aggressive, related research, that is, in the sense underlying this discussion: that public relations activities commensurate with professional standards should simultaneously state objectives and create the public reception necessary to their existence. Possible examples might include modification of the arbitrary and misleading phases of the going-concern, accounting-period, and entity concepts.[13]

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[11] Cf. Henry W. Sweeney, *Stabilized Accounting*, (New York: Harper and Brothers, 1936) and W. A. Paton, *Advanced Accounting*, (New York: The Macmillan Company, 1949), Ch. XXXIII, "Common-Dollar Reporting", pp. 731-48.

[12] For an interesting discussion of how accountants' services can be expanded, see Stephen Chan, "The CPA's Services to Business", *The New York Certified Public Accountant*, March, 1951, Vol. XXI, No. 3, pp. 183-88.

[13] Cf. George O. May, "Truth and Usefulness in Accounting", *The Journal of Accountancy*, May, 1950, Vol. 89, No. 5, p. 387; and Oscar S. Nelson and Arthur D. Maxwell, *Accounting Systems*, (Chicago: Richard D. Irwin, Inc., 1950), p. 26: "Generally Accepted Accounting Principles".

The profession of accountancy in the United States has a past of which it is proud. But its past is not an ancient one, for ours is a young profession. If accountancy is to reach the point where the whole membership receives psychical and material rewards proportionate to requisite training and intelligence, we must earn and deserve greater public respect and faith than we can claim at the present time. Public relations activities can contribute to the hoped-for recognition of the value of our work. But public relations programs not geared to and not reflecting group dedication to real public service, cannot succeed. In order to win greater acceptance, we must respond to the questioning voice of public opinion with clear and honest information based upon innovative planning. We should emphasize particularly our future objectives which are designed to make our work progressively more valuable to the community. In turn, free men reacting intelligently during the nation's present difficult period can encourage the progress of the accounting profession and assist in the eventual achievement of mutual objectives. Such a partnership forms a sound basis for the harmonization of public relations with professional responsibility.

How to Prepare for the Auditor

(Continued from page 532)

course, with prospective building, long-term commitments for acquisition of supplies, anticipated purchases, etc.

One additional consideration that the client should not overlook is the matter of adequacy of physical arrangements for the visiting auditors.

In these days of considerable advancements in lighting arrangements and in the arrangement of tables and chairs, etc., the client certainly should make every endeavor to provide the accountant with a convenient place to work. He is, of necessity, often dealing with highly confidential matters and highly confidential papers. He should have opportunity to review them with some privacy, and yet his location should be convenient to the general books of account and to other records which he will often find essential. The greater efficiency of both client and auditor will be well served if these arrangements can be effected.

A good deal of variation will occur in this cooperative venture, depending upon the extent of the internal audit staff maintained by the client. In at least one case the working plans for the year are reviewed by us with the client's chief internal auditor and in general the work is plotted for the entire year in advance in consultation with our supervisor. Our own visitations, not only to the main plant but also to the branches, are then planned in coordination with the projected work of the internal audit staff. At the end of the year we render a special "report on internal control" which will summarize our findings not only as to the efficiency of the internal check and control generally, but as to the efficiency of the internal audit staff as well. This, of course, has an important influence on the planning of the internal audit staff for the succeeding year. We sometimes render two such reports—one in very considerable detail and covering only those minor matters which we feel not of sufficient importance or consequence to call to the attention of the Audit Committee of the Board of Directors, and a separate shorter report of matters which we feel are of importance and which should be called to the attention of the Audit Committee.

The Nature of Non-Profit Institutions Accounting

By EARLE L. WASHBURN, C.P.A.

IN recent years lavish contributions have brought many non-profit institutions into the field of big business and focused public attention upon them and their complex operations. Simultaneously, the problem of accounting for these operations is far removed from the simple problem it once was when, for example, the professor of mathematics traditionally kept the college financial records. The advent of the withholding tax, the recogniton of unions and, more recently, the extension of the federal social security benefits to these institutions have all combined to complicate further their accounting procedures and expenses.

These institutions are generally classified as "charities." Hence the law of charitable trusts exerts a great influence on the accounting of these institutions and has given rise to what is referred to as the "fund balance sheet" peculiar to them. Efforts to explain to the uninitiated the basic philosophy underlying "fund accounting and the fund balance sheet" is a never-ending challenge to the most skillful. Yardsticks such as the percent of gross profit, ratio of current assets to current liabilities, net worth, etc., commonly employed in appraising the financial condition of a business enterprise consecrated to earning a profit for the owners, are largely useless when applied to the balance sheet of a non-profit institution whose accounts are kept on a sound "fund basis."

Now just what does the term "non-profit" mean, what are some of the organizations falling within this category, what is the significance of the term "fund accounting" and what are some of the problems?

The term "non-profit" means that "no part of the income inures to the benefit of any private shareholders." Salaries and wages are, of course, paid for services rendered but there is no distribution of "net income," all of which is retained in the business; and the balance sheet contains no capital account or other evidence of "owners' equity," since there is no private ownership of any of the assets.

Non-profit institutions include, but are not limited to:

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Mr. Washburn is Director of Accounts at New York University from which he received the degrees of Bachelor of Science and Master of Commercial Science. From 1920 to 1943, he was also instructor in accounting in the School of Commerce, Accounts and Finance. He is the author of "Accounting for Universities" published by The Ronald Press Company in 1926.

Mr. Washburn is a Research Associate of the accounting firm of Chambellan, Berger and Welti, C.P.A's.

These remarks were delivered by Mr. Washburn by way of introduction to the technical program conducted by the Committee on Non-Profit Institutions Accounting held on April 12, 1951, at the Engineering Societies' Building in New York City.

The Application of the Principles of Accounting to Account Keeping for Non-Profit Institutions

By MAX WASSER, C.P.A.

Institutional Accounting vs. Commercial Accounting

To those who are quite familiar with the several forms in which business financial data are prepared, financial statements issued from time to time by non-profit organizations may be somewhat confusing. Institutional lay management (as distinguished from the professional management), as well as interested contributors, often cannot comprehend why the reporting and underlying accounting practices of non-profit organizations are not similar to those of commercial enterprises with which they are familiar.

Why such variations exist in the forms of financial statements issued by business enterprises and non-profit institutions respectively, may best be understood, by considering the basic objectives of each.

Profit Motive vs. Service Motive

The fundamental purpose of a commercial enterprise is to create a profit for its investors. On the other hand, the primary objective of an institution is to render a needed service in the most efficient manner possible. The term "profit", as an ultimate objective, is inconsistent with the purposes of an institution. In order that its spending may be restricted insofar as possible within the framework of its income from all sources, a well-managed institution guides itself on the basis of carefully planned, detailed budgets, both as to expected income and estimated expenditures. It follows, that the budget of an institution is somewhat inflexible in that its expenditures are definitely limited to its estimated income; whereas budgets, when employed in business, are necessarily flexible because of the variability of economic and inherent business factors.

A successful institution is one which has utilized its available funds wisely in rendering its services. On the other hand, the success of a business enterprise is usually measured by the extent to which its capital has been increased through profitable operations.

Sources of Capital

A business receives its initial capital from funds invested, with an expectancy of return. Subsequent changes in business capital stem from the results of its operations, and/or additions or withdrawals. An institution receives its funds through gifts such as contributions, legacies, subsidies; and, also, through charges for services rendered. Whereas the proprietorship section of a balance sheet of a business enterprise represents in effect, the equity of the owners, the similar section of an institugation to perform a particular service. tion's balance sheet represents an obli-

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This paper was presented at a technical meeting of the Society, held on April 12, 1951, under the auspices of the Committee on Non-Profit Institutions Accounting.

Terminology

Funds and Fund Groups

Standard methods of account-keeping for institutions are often described as "fund accounting." A more apt description would be "accounting for funds." Assets when received are classified under respective "funds" according to the purpose for which received, each being separately controlled. A class of funds becomes a self-balancing unit when its assets are considered together with related liabilities, reserves, and principal, the latter representing the amount available for the purpose of the fund. Each such unit, consisting of its assets, liabilities, reserves and principle is, more often than not, called a "fund"; but the better accounting terminology would be "fund group."

Reserves

In October, 1948, the Committee on Accounting Procedures of the American Institute of Accountants issued its Accounting Research Bulletin #34 approving, as an objective, the findings of its Committee on Terminology. In this Bulletin, the Committee suggested that, in order to make financial statements more readily understood, the term "reserve" should be limited to only one usage, namely, as an appropriation of retained earnings for a special purpose. Such reserves are designated as "principal" reserves by non-profit organizations, examples of which are "Reserve for Plant Expansion"; or "Reserve for Pending Litigation."

In non-profit institutions, the term "reserve" has often been used to denote the principal of a fund (excess of assets over liabilities). Here again, it is suggested that the principal or balance of a fund should not be described as a "reserve", in order that such term be restricted to its usage as a principal reserve, as described above.

Many institutions establish principal reserves through charges to operations. The proper creation of such a reserve should be through a charge to the principal account.

Classification of Accounts

Fund groups or fund units are usually classified into five major categories:

1) Current Funds
2) Temporary Funds for Designated Purposes
3) Endowment Funds
4) Plant Funds
5) Agency Funds

Current Funds (sometimes called General Fund or General Operating Fund or Operating Fund)

These are the funds utilized for:

a) Functional operation (educational, scientific, hospital care, religious, old age, child care, etc.)
b) Administration (salaries, office equipment, stationery, supplies, etc.)
c) Physical maintenance and operation (heat, light and power, janitorial services, etc.)
d) Fixed charges of an annually recurring nature (pensions, annuities, taxes, etc.)

Current Funds are unrestricted in nature and arise from contributions, unrestricted legacies, service charges, income from the investments of its own funds as well as from those of the permanent and temporary funds, etc.

Temporary Funds for Designated Purposes

As the classification implies, such funds are received for specific purposes of a temporary nature rather than for fixed or permanent purposes. The terms of the gifts establishing these funds may permit of the use of both principal and income.

Endowment Funds (sometimes called Permanent Funds)

Endowment Funds are permanent in nature. In other words, the principal is non-expendable and held in perpetui-

ty. Usually invested in securities, the endowment fund becomes a permanent source of income which must be utilized for such purposes as the donor has directed. If no restrictions apply, the income may be used for any purpose determined by the governing board. Unrestricted income is often channelled to the General Operating Fund.

Plant Funds

These are represented by investments in land, buildings, equipment and other fixed assets of the institution.

Agency Funds

This classification relates to those funds in which the ownership does not rest in the institution, but for which it must be accountable. An example of such funds are the assets of students' organizations deposited with the institution.

Cash or Accrual Basis

As non-profit institutions generally are tax-exempt, they are not required to adhere either to a cash or an accrual basis of accounting. In practice, some do, as a matter of policy, adhere strictly to one or the other; but many, for conservative reasons, combine the features of both, the income being recorded on the cash basis and the expenditures on the accrual basis.

The Nature of Non-Profit Institutions Accounting

(Continued from page 538)

1. Colleges and universities.
2. Voluntary hospitals.
3. Welfare federations.
4. Church bodies.
5. Charitable foundations.
6. Organizations devoted to the relief of distress in all its forms.

The term "fund accounting" arises from the origin of the institutions' capital funds, consisting of cash contributed by individuals or groups who are interested in the charitable object envisioned by the founder, that of rendering a service to the community within the limitation of the funds thus contributed. This concept must always be kept in mind, for it is fundamental in determining the applicable accounting theory. Now, a donor has a right to expect that any gift will be efficiently administered and the selection of an institution by a donor is evidence of his faith in the integrity of its trustees.

Among other obligations, they must see to it that cash received for permanent endowment or other restricted purposes is not diverted to nor dissipated for current expenses or some object apart from that contemplated by the donor. To reflect the legal sanctity of these endowment and other restricted receipts, procedures known as "fund accounting" have been devised, the object of which is to segregate the receipts of an institution according to the restrictions on their use as determined by the source. For instance, cash received for an endowment fund may not be employed to liquidate indebtedness arising from an operating deficit and these endowment assets cannot be attached in a bankruptcy action to satisfy general creditors. It is a legal maxim that "charity is the favorite of equity" and the courts have traditionally taken a broad view in determining the rights of charity in a civil action, though recent decisions in tax exemption cases have cast some doubt on the continuation of this policy.

The papers that follow will treat of certain special accounting problems of non-profit institutions.

Budgetary Control for Colleges and Universities

By Howard A. Withey, C.P.A.

Much has been written on the subject of budgets, their advantages, methods, application and general acceptance in business as well as in non-profit organizations. Budgetary control is required in colleges and universities to a greater extent, perhaps, than in any other kind of activity. The enormous increase in costs over the past ten years, the decline in yield on investments and the future prospects of widely fluctuating enrollment make it mandatory for educational institutions to control their operations so that deficits will not accumulate beyond the financial resources of the institution. Most of the larger universities have developed the technique of budgetary control as a means of administrative control over operations as well as an instrument of educational planning. Many of the administrators of smaller colleges are now finding that a properly prepared budget leads to greater understanding on the part of the Board of Trustees, particularly if the Board accepts its obligation as to the financial stability of the institution. It is incumbent upon the administrator of an institution to keep within the budget accepted by his Board, and it is the purpose of this paper to explain, in a general way, the means by which such control can be achieved.

Howard A. Withey, C.P.A., has been a member of our Society since 1933. He is a partner of Franke, North, Hannon & Withey and is presently serving on the Committee on College and University Accounting of the American Institute of Accountants which was formed to review the revised manual on College and University Accounting prior to publication.

This paper was presented at a technical meeting of the Society held on April 12, 1951, under the auspices of the Committee on Non-Profit Institutions Accounting.

First, there are several fundamental principles which must be understood:

1. The Board of Trustees of an institution is responsible for its financial policies as well as its educational or other administrative policies. An approved budget represents the determination of amounts of expenditures by areas and accordingly represents the establishment of financial policies. It follows, therefore, that over-expenditure of budget allotments should be consdered in the same light as any other contravention of Board policy.

2. To be of value, the budget must not be an "educated guess" but must be based upon careful estimates of anticipated income and departmental needs.

3. The budget should not be considered as a fixed, ironclad determination of future operations, but should be subject to change by the Board or the appropriate committee as conditions warrant.

4. Both the budget accounts and the accounting classification must be similar and must be based upon areas of control. For a large university the primary areas would be by colleges or divisions, and in a smaller organization it might be by divisions of study such as natural science, physical science, humanities, etc.

Preparation of the Budget

The President of the institution is responsible for the budget. Usually, the

accumulation of statistics and the obtaining of data for the budget is delegated to the Business Manager of the institution or to the Chief Accounting Officer. For convenience, the term Budget Officer will be used. The responsibility of the Budget Officer, except as to his own department, is limited to a factual presentation, since he has no discretion or responsibility as to the items which are to be included or excluded in any departmental budget. Since the budget should be prepared and approved before the start of the fiscal year to which the budget applies, complete data with respect to the current year's operations are not available and, therefore, the Budget Officer must accumulate statistics with respect to prior years and estimates for the current year. These figures are submitted to the heads of the various departments or divisions with the request for data for their budgets for the following year. The division heads may, in turn, transmit the appropriate data to subordinates in the areas of their responsibility. Any additional information which may be of value to the department or division head is furnished by the Budget Officer and all of the pertinent facts are usually discussed at meetings between the Budget Officer and those responsible for departmental budgets.

The form of the request for budgetary information is usually standardized so that the Budget Officer can fit the data into a uniform classification for the purpose of budget presentation and for subsequent accounting classifications. The information with respect to each budget account is divided between (a) salaries, (b) supplies and expense, and (c) equipment. Under the salary classification is listed each full-time position and the salary of the position, such as professors, associate professors, assistant professors, instructors, etc. The supplies and expense classification is broken down in accordance with a standard object classification such as stationery and printing, telephone and telegraph, travel, repairs and renewals, etc. Under the equipment classification is listed specifically the new equipment required for the coming year, with an estimate of the cost of each item. The individual budget accounts are then tabulated and summarized by the Budget Officer and submitted to the President of the institution, together with data with respect to prior years, the current year, etc. In many instances, an explanation or justification is attached where increases in the budget are requested.

The Budget Officer usually prepares the income estimate after consultation with the Registrar as to anticipated student enrollment; with the Investment Officer as to endowment income; with the President and with department heads as to gifts and grants for current purposes; and with the Manager of service enterprises with respect to the income of these activities. The income budget is submitted to the President with the summaries and data for allotments submitted by the various department heads.

The President reviews the requests of the various departments with the appropriate individuals and makes the final determination, subject to approval by the Board, as to the authorizations for each department and division and the individual budgetary accounts within each department. It is his responsibility to reconcile the anticipated enrollment with the teaching loads of each instructional division and to determine appropriate salary allotments for the various positions. After the President has decided on these matters of policy and has determined the allotment for each department, the Budget Officer makes the appropriate revisions and recompiles the budget for submission to the Board of Trustees or to the appropriate committee.

Operation Under the Budget

Upon approval of the budget by the Board of Trustees, the Budget Officer submits copies of the final budget to the Chief Accounting Officer and to

other individuals concerned. One of the copies is used as a master copy to reflect subsequent changes and adjustments. At the beginning of the new fiscal year, the budget totals are recorded in the general ledger of the institution by debiting estimated income, crediting appropriations and debiting or crediting the difference to an unappropriated balance account for the current year. The details supporting the estimated income are recorded in the subsidiary income ledger so that the total in the general ledger is a control account over the income ledger. The appropriation for each budget expenditure account is likewise recorded in a subsidiary budget ledger by account, and the appropriations account in the general ledger becomes the controlling account for the budget and expenditure accounts. Changes in the budget during the year are recorded by journal entries in the general ledger as well as in the subsidiary ledgers. As income is received, the appropriate account is credited and the balance represents the unrealized income of the account. Expenditures represent debits to the appropriate budget account, and the balance represents the free balance available for expenditures.

In order to simplify executive control over the appropriation accounts, the budget ledger is generally subdivided for each account as to (a) salaries, (b) supplies and expense and equipment, (supplies and expense and equipment being recorded on one ledger sheet). By using a multicolumn sheet for each budget ledger account, provision is made for the recording of encumbrances against the account. The budget ledger sheet therefore has three divisions (1) orders outstanding (2) expenditures and (3) budget and free balance.

Practice varies as to the level at which the encumbrances are controlled. Some institutions record the requisitions and some the purchase orders. For smaller institutions having no centralized purchasing department, a control on the purchase order level seems to operate satisfactorily. Control over the budgets must be exercised at least at the purchase order level; otherwise, commitments may be made for amounts which would overexpend the appropriations. In smaller institutions effective control can be maintained by routing all purchase orders through the accounting department for approval as to the availability of a budget appropriation before the purchase orders are submitted to vendors. This does not necessitate the establishment of a central purchasing department, and the purchasing authority can still remain in the various departments except that the purchase order must be approved as to availability of a budget appropriation before the purchase order can be issued. After certification of the availability of the budget, a copy of the purchase order is retained in the accounting department. This copy is used as a medium for recording the encumbrances against the appropriation and the decrease in the free balance of the particular appropriation account.

Upon receipt of the invoice covering the order, the amount shown thereon is recorded as an expenditure in the appropriate account, the encumbrance is reduced by the amount of the related purchase order, and the free balance is adjusted for any difference between the purchase order amount and the invoice amount. The budget ledger sheet provides for accumulated totals of the encumbrances, expenditures, budget and free balance.

Since the obligations of the institution are recorded at the purchase order level, there is no necessity for recording accounts payable in the form of unpaid invoices. This procedure eliminates the necessity of a voucher register and makes it possible to record the expenditures on a cash basis. Disbursements are charged to the appropriations control account in the general ledger from the cash disbursements record and corresponding entries in the budget ledger keep the detailed budget ledger ac-

counts in agreement with the control account. Some institutions do not record purchase orders or other encumbrances against the budget accounts for auxiliary enterprises such as dormitories, dining halls, book stores, etc. Other institutions have adopted a method of standing purchase orders, which are authorizations to a vendor for an aggregate amount of purchases for a specified period of time. This practice, in my opinion, results in better control over the accounts of the auxiliaries. One institution, with which I am familiar, has further refined this practice by recording vendors' bills at the end of each month as encumbrances against the operation of auxiliaries. This practice permits the preparation of financial statements of these operations on an accrual basis since these invoices would not ordinarily be recorded until the time of payment in the following month.

Most institutions have inter-departmental transactions. If these items are significant, a system of inter-departmental requisitions should be established so that the availability of budgets can be determined before the charges are incurred.

Financial Statements

Monthly trial balances of the income and budget ledgers, if taken off the accounts in the proper form, may serve as operating statements. The income trial balance should be taken off in three columns:

(1) Estimated (budget estimate)
(2) Realized to date (accumulated income)
(3) Unrealized (balance of estimate not yet realized)

The total trial balance should cross-foot and the unrealized balance should agree with the estimated income control account in the general ledger.

The trial balance of the expenditure budget ledger should be subdivided for statement purposes as between (a) salaries, and (b) supplies and expense and equipment. The trial balance of the salary accounts should be set up in three columns:

(1) Budget
(2) Expended to date
(3) Free balance

An additional column, between the "Expended to date" and "Free balance", may be added if the institution wishes to encumber the salary budgets for the full-time salaries of teachers on appointment and for full-time clerical or other employees.

The trial balance of the second group, i.e., supplies and expense and equipment, should be set forth in four columns:

(1) Budget
(2) Expended to date
(3) Encumbrances
(4) Free balance

The total of the free balances of the salary group and the supplies and expense and equipment group plus the total of the encumbrances should agree with the appropriations account in the general ledger. The amount of the encumbrances must be added to the total of the free balance since the encumbrances are recorded as charges against the budget but are not recorded in the general ledger.

A close study of the unrealized income accounts and of the free balance accounts will indicate first, whether the departments are keeping within their budget allotments, and secondly, the areas where budget adjustments are desirable or may be required. These items are usually called to the attention of the President who will request the Board or the appropriate committee for authority to make necessary budget changes. For example, because of increased costs a higher proportion of the fuel budget may have been expended to the interim date than would normally have been expected. If it is apparent that the original budget requires adjustment, such an adjustment should be requested so that the balance between the total estimated income and

the appropriations for the year can be used as an indication of the operating results for the period. Similarly, one of the salary appropriation accounts may be under the allotment for the period because a particular position has not yet been filled. The amount of the budget for this position to date, and perhaps for the current semester, should be deleted from the budget since the amount will not be expended. Increases or decreases in student enrollment, as compared with the original estimates, should be reflected by budget adjustments as soon as the amounts of such adjustments are determinable. By making budget adjustments during the year, as are indicated from a study of the monthly financial statements, the administration and the Trustees can be kept fully informed as to the anticipated operating results and may initiate any action which may be required to meet changing conditions, not only for the current year but on a basis of long-term policies.

The current statements of budget income and expenditures should be supplemented at least by a balance sheet of current funds. This balance sheet contains the usual items of current fund assets and liabilities except that, for the purpose of control, other accounts should be added. These accounts have been previously explained, but are summarized as follows:

(1) *Estimated income—*

At any interim balance sheet date this account will represent the unrealized balance of the estimated income. It is generally customary to reflect this item by stating the amount of the estimated income and deducting the income realized to date.

(2) *Appropriations—*

This account represents the unexpended balance of budget appropriations at any balance sheet date, and is usually reflected by stating the amount of the budget appropriations and deducting the expenses and encumbrances to date.

(3) *Unappropriated balance for current year—*

This account represents the difference between the anticipated income as shown in the budget and the budget appropriations. If the difference is a credit balance, it should be added to the accumulated surplus of prior periods and if it is a debit balance, it should be deducted from such surplus.

(4) *Reserve for orders and contracts outstanding—*

The total amount of orders and contracts outstanding is shown in the statement of budget expenditures. Even though this amount is not reflected in the general ledger, it should be reflected on the interim financial statements by deducting the amount from the general ledger control account for appropriations.

Copies of all or parts of the interim statements may be furnished department or division heads, managers of auxiliaries, etc., for their guidance.

The annual report of an educational institution can be prepared in the same general form as the interim financial statements. There are some peculiarities in the financial statements which are not common to commercial enterprises and which might be mentioned.

1. At the time of closing the accounts of the institution, the commitments or purchasing orders outstanding against each budget account are tabulated and reviewed with the purchasing authority to determine whether or not such commitments should be canceled, or whether the merchandise will be received in the subsequent period. The purchase orders or commitments which are to remain in the accounts are classified as expenditures and the total of such commitments is recorded as a liability in the general ledger. The subsequent payment of such commitments is charged against the liability account in the succeeding period rather than being charged

as an expenditure of that period. Purchase orders representing items usually includible in inventories or supplies consumable in the subsequent period may be eliminated from the approriation accounts of the current year and reflected in the balance sheet as advances or deferred charges. These orders are re-entered as commitments against the following year's appropriations. For purposes of the annual report, the amount of the outstanding commitments is sometimes divided between commitments for which invoices have been received at the time of the closing of the account, which is classified as accounts payable, and other orders and contracts outstanding.

2. The amount of the unrealized income accounts and the free balances shown by the appropriation accounts are closed out against the unappropriated balance account so that the remaining figure is the actual income or deficit for the current period. Certain appropriations may be applicable to a different period than that of the fiscal year of the institution. In such cases it may be advisable to reduce the free balance of the particular appropriation accounts before closing by setting up a reserve for balances subject to reappropriation. These balances are then reappropriated by the Board and upon such reappropriation are added to the appropriations of the particular accounts affected for the fiscal period for which reappropriated.
3. The statement of expenditures in the annual report may be subdivided for each account so as to show the object classification of the expenditures. These object classifications are recorded by a code number or letter at the time of recording the expenditures in the budget ledger and are summarized periodically during the year. An object classification code is used for equipment which makes it possible to combine these expenditures on the budget ledger sheet with supplies and expense.

General

For the purpose of effective budgetary control, budgets within certain classifications are delegated to various levels of administrative authority. For example, the head of a division may be delegated the authority of changing the budget allotments with respect to the various accounts within his division as long as the total remains unchanged. Likewise, the Chairman of the department might be delegated the authority to make changes within his department which would not change the total budget allotments. The President of the institution may be delegated the authority to change estimated income or appropriation accounts to the extent that the totals are not changed. Usually the President may also authorize changes in the budgets of auxiliary enterprises as a result of increases or decreases in the estimated income of the auxiliaries. In many cases authority over the various areas may be exercised by the administrator of the area with respect to supplies and expense only, the President retaining sole control over salary and equipment allotments.

From articles which have appeared in our professional publications, it appears that there are a number of fundamental misunderstandings on the part of public accountants as to the principles of accounting for colleges and universities. It is hoped that this paper will not only give the practicing accountant a general idea of the application of budgetary control to institutions, but will help to eliminate some of this misunderstanding. The public accountant who can convince his institutional clients as to the advantages of budgetary control will be performing a lasting service, since such control provides a most effective tool for educational administration.

Depreciation as Applied to Institutional Property of All Kinds

By ALICE H. AUBERT, C.P.A.

DEPRECIATION has come to be a bone of contention in institutional accounting. In the early days of institutional accounting each institution had its own accounting methods. Some of these methods were the result of a lack of bookkeeping knowledge, some were cumbersome and inflexible, some were good, but none were uniform. When it was realized that comparisons of the financial statements of similar institutions could be useful, it was also realized that such comparisons were not easily possible because of the dissimilarity of record keeping. Soon there came into existence such groups as The National Committee on Municipal Accounting and the National Committee on Standard Reports for Institutions of Higher Education, which, after much exhaustive study, suggested standard accounting methods, procedures, and reports. These suggested methods were rather generally adopted at least by the larger of the various types of institutions (namely governments and municipalities, schools and colleges, hospitals, eleemosynary institutions, and other non-profit organizations), and for a while institutional accounting problems seemed to be solved. Institutions settled back into a comfortable accounting rut. Then with changing times, thoughts, and ideas some improvements suggested themselves, and seemed to be warranted, others were recommended and brought about definitely divided schools of thought. Among these latter is depreciation.

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Following is a summary of the reasoning of each school of thought on the subject of depreciation, and a brief discussion thereof. It might be well to point out first that it is conceded by almost all concerned with the question of depreciating institutional properties, that, should depreciation be taken, it would be of little value to many institutions unless the reserve were funded.

Opposition to depreciating institutional properties will be considered first because not to depreciate it is the more commonly recommended and adopted practice at present. The institutional properties to be considered are those used for the regular operation of the organization and usually included in the Plant Fund. Everyone is rather generally agreed that depreciation should be taken with respect to depreciable assets held as investments of endowment funds or property used for auxiliary or profit-making enterprises and activities. The reasons advanced

in these cases are that, as to the former, the principal of the endowment fund must be kept inviolate, and as to the latter, the total cost of the enterprise must be known in order to determine fees or other charges, and also, depreciation must be accounted for if the property is to be replaced out of income from the activity.

The arguments against depreciating non-profit producing properties are:

1. Such property is usually received as a grant, gift, or bequest, and it is reasonable to expect to receive replacements in the same manner from future generations.

2. Since grants, gifts, bequests and even appropriations incur no obligation to amortize, write-off, or set aside funds out of current income for replacement, depreciation is not necessary.

3. The inclusion of the cost of depreciation in current operations of a college or university would increase the students' tuition rate if such rates were intended to cover current costs. In the case of donated property this would increase the cost to a student, when as a matter of fact the property was donated for the purpose of reducing the cost.

4. Institutions are not interested in profits or the recovery of costs for future replacement, but rather in the application of funds acquired to current needs.

5. Governments and municipalities are not interested in the depreciated value of property since it cannot be used as a basis of credit.

6. Unless specifically provided in a legislative grant or appropriation it would be illegal for governments and municipalities to fund a depreciation reserve.

7. Hospitals do not usually have enough funds to meet even current needs, and so have not wanted to overburden themselves more by providing for future needs.

Many of those opposed to charging depreciation against current income agree, however, that a knowlede of the amount is helpful for many reasons, and recommend that such costs be calculated, and maintained in a subsidiary record.

The protagonists of depreciating institutional properties advance the theory that failure to do so gives an incorrect picture of the cost of operation. They maintain that, should a pressing need for replacement arise during a period of economic depression, the inadequate provision for meeting total cost currently might prohibit entirely, and at least jeopardizes, carrying out the objective of the organization over a prolonged period. They feel that a statement which does not include a depreciation charge against current income might be misleading to those who rely on it for either income or operating needs, and does not give the true facts to those who contribute to the cost of operation. They also feel that recognizing depreciation cost, and providing for future replacement, insures the continuance of the organization and its work, and serves the community better.

There is much that can be said in favor of both sides of the question. While it is esthetic to believe that future generations will continue to provide as lavishly as in the past, the present cost of living and high taxes leave fewer people in the world today in a position to amass resources similar to those accumulated by prior generations. The argument that grants, gifts, and bequests incur no obligation to provide for replacement seems a little weak. There would seem to be no more excuse for a university, for instance, to burden its alumni unduly for its future existence than there is for the population in general to expect the government to support them in their old age without any contribution or effort on their own behalf. On the other hand, the argument that a building is donated for the purpose of reducing a student's education costs, and charging depreciation currently could nullify this pur-

pose, is a good one. This, however, is one of the weaknesses of well-intentioned gifts. Frequently they restrict or impede progress by their provisions, or even result in expense rather than income. But it should be remembered that if there were no property, or if the institution had to occupy rented property, there would either be no institution, or there would be rental expense which usually exceeds the cost of depreciation, and in this latter case there would be some saving. The argument that depreciation charges might raise a student's tuition rate in a college or university is also a good one, and can be tempered only by the realization that they, the students, are the main element in bringing about a more rapid depreciation of the institution's property, and perhaps, ought to bear some of the expense.

It is understandable that the trustees of institutions feel a strong responsibility to apply to the fullest funds donated for the operation of an institution. However, it would seem that, with a good educational program, donors could be made to realize that operation for current needs alone is really a step backward, and that current funds should be reserved for future needs if the institution is to serve generations effectively.

Governments and municipalities are perhaps in a better position than any other type of institution to argue against depreciation, because they have other means, such as floating bond issues and raising tax rates, by which they can provide for replacement, which means may not be available to other types of institutions.

Although, as has been mentioned, current hospital funds are usually insufficient for current needs, nevertheless, hospitals now recognize the importance of including depreciation in current operations, and are beginning to do so. The reasons for this change in attitude are several. One is that the comparison of departmental expenses from period to period is difficult when replacements are charged directly to expense, and variations are thereby large. Another reason is the inconsistency of charging depreciation in determining costs of contracts for outside agencies, but not including it in operations in determining other ordinary costs.

The most practical objection to depreciating institutional property, and probably the most difficult to refute, is that the funds just are not available to do so. This is particularly true in small organizations. And in such cases, at least, it would seem that, unless the reserve is funded, depreciation is just a book entry with little meaning, and only adds more to the deficit.

The arguments in favor of depreciating institutional property are all good because they treat the question from the standpoint of good business management. And despite arguments to the contrary, the true costs of operating any organization should be determined in preparing the current budget, and these true costs would include provision for replacement of the property used to carry on the work. The proponents of this idea have been accused of applying commercial accounting technique to non-commercial organizations. There seems to be nothing intrinsically wrong in doing so, except perhaps for the fact that such ideas infer that current funds are or will be sufficient. In some institutions this theory may be a little idealistic.

From all of the foregoing it seems that the question comes down to a simple matter of (1) faith in human nature vs. faith plus some assistance from management; and (2) availability of current funds. Therefore, it would seem more proper to consider each institution from the standpoint of its own needs and prospects, and to treat its accounting accordingly, rather than to apply a blanket theory to all. However, for the benefit of comparisons of figures of like organizations, each institution should calculate the depreciation cost so that it is available if needed in making comparisons.

The Inclusion of Depreciation of Hospital Plant and Equipment with Operating Costs

By JULIAN S. H. WEINER, C.P.A.

A PROBLEM that has perpetually plagued hospital management and accountants is the treatment of depreciation with respect to hospital costs. There are three major prevailing views on this subject: (1) One group supports the establishment of provisions for depreciation, but will not consider such charges as an element of operating expense. (2) Another substantial segment of opinion ignores the principle of depreciation and, in lieu thereof, advocates the inclusion of equipment replacements in operating expenditures. (3) The third, and minority view to date, contends that hospitals should adopt the commercial treatment of depreciation. That is, depreciation should be considered as a *bona fide* operating cost. It is this author's belief that the latter is the more desirable approach.

Depreciation in Commercial Enterprise

Before discussing the various issues created by the aforementioned diversity of opinion, it would be expedient to review the concept of depreciation as applied commercially. It is generally conceded that every expenditure of a business ultimately will be considered as an expense. If the item purchased is consumed in the current financial period it will be incorporated in the related cost. However, purchases of furniture and equipment represent more permanent acquisitions, which will be utilized over a span of several years. It would be improper, therefore, to charge the entire cost of such outlays only to the period in which they were made. Hence, the theory of depreciation was conceived to resolve this problem. By application of this procedure, the purchase price of such an item is allocated over the estimated period of its utilization, thereby avoiding a distortion of operating results for the periods in which substantial expenditures of this nature are made. This method of distributing the costs of fixed assets over their lifetime represents the generally accepted accounting procedure for commercial enterprises. In addition, this practice is permitted by all governmental agencies for the preparation of income tax returns.

It would seem proper that a hospital's fixed assets should also be subject to depreciation, unless special equities exist which would exclude such institutions from the application of this generally recognized policy. Bearing this in mind, it is the intention of the author to examine the opposing viewpoints referred to in the introductory paragraphs, to ascertain whether there is any justification for distinguishing the furniture and equipment of hospitals from those of commercial enterprises, with respect to the subject of depreciation.

1. Depreciation Recorded, but Excluded from Operating Expense

The method whereby a provision for depreciation is recorded, but is not included with the operating costs, usually represents an attempt to maintain an

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evaluation of the hospital plant. The proponents of this policy believe that it would be inequitable to incorporate the provision for depreciation with the regular costs.

It is contended in support of this position that a hospital is a charitable institution which is maintained substantially by public contributions. It is further alleged that hospitals purchase their fixed assets primarily from funds donated specifically for that purpose. Consequently, the inclusion of depreciation in operating costs, in addition to the raising of funds for the acquisition of plant capital, would impose a double burden on the public.

In the author's opinion these arguments fail for the following reasons:

Equipment expenditures are made from operating as well as contributed income.

The assumption that hospitals purchase their fixed assets, other than buildings, only from earmarked contributions is inaccurate. General public contributions are commingled with the proceeds of operating income, and it is primarily these funds that are expended for hospital equipment. Therefore, this merger of income precludes the possibility of identifying the source of funds utilized for such acquisitions.

Depreciation is an expense, no matter who pays for it.

Let us assume, *arguendo*, that fixed assets are procured primarily from donations and, consquently, that the public would be paying twofold if depreciation were incorporated in operating costs. The logical conclusion to be derived from such a viewpoint is that the inclusion in operating costs of any expenditure made from donated funds would impose a duplicate charge upon the patient. Let us now examine the ultimate effect of applying such a proposition. The average voluntary hospital operates at a material deficit. Hence, a substantial amount of operating charges must be expended from contributed income. Therefore, to the extent that the operating deficit is offset by donations, the related expenses comprising such deficit should be extracted from operating costs. It is obvious that the exclusion of such items would distort financial statements beyond recognition.

In view thereof, the source of the funds employed to purchase an item should not furnish the criterion for its disposition in an operating statement. This is further illustrated by the general treatment of gifts in kind. To reflect the receipt of a donation in kind, the related expense account is debited and the credit is usually posted to an account called "Donations in Kind." Thus, in spite of the fact that the item is specifically donated, it will be included with the cost of operations. This practice appears to be completely contradictory to the position maintained by the opponents of "depreciation as an operating cost." Yet, in spite of this apparent inconsistency, the foregoing treatment of gifts in kind is viewed with favor by this group.

This writer is also in complete agreement with this approach, for if donated supplies were excluded from expenses, the operating requirements would be understated accordingly.

Why then should fixed assets be differentiated from other items? They are as necessary as medical and surgical supplies for the operation of a hospital. The distributions of the cost of equipment over the related estimated life expectancy is merely a device for the reasonable allocation of such expense. In principle, it is similar to the inventory method whereby, at the end of a financial period, all supplies not consumed are inventoried and subtracted from the related expenditures. In effect, supplies also are considered as a charge to the period utilized rather than at the time of procurement.

Therefore, it appears that to distinguish the cost of equipment from other expenses represents an arbitrary rather than a logical selection.

Voluntary hospitals are not completely charitable.

A voluntary hospital usually offers three major categories of service; private, semi-private, and ward. It is expected that the wards will be operated at a loss. However, the semi-private and, especially, the private divisions are intended to be maintained at a profitable or at least self-sustaining level. To this extent, therefore, a hospital is not considered a charitable institution. The allocated cost of equipment or depreciation of such assets represents a substantial factor of operating costs. The exclusion of this item from expense will result in the understatement of the costs to be recovered from private and semi-private patients. This is particularly true where patients are treated on a contractual basis, such as Blue Cross, etc. Consequently, public contributions would be utilized to offset the cost of operating private and semi-private, as well as ward accommodations. This condition most assuredly does not represent the intention of the average contributor. Therefore, to avoid the foregoing result, it would appear reasonable that depreciation be reflected in operating costs.

2. Equipment Replacements Charged to Expense When Purchased

Now let us analyze the nature of the equipment replacement theory, the second method referred to in the introductory paragraph. Under this procedure, all equipment expenditures which represent replacements are charged to expense in the period of purchase. Only completely new plant additions, not utilized previously, are capitalized. With the exception of such items, the cost of the original plant assets will be represented by a static figure on the records. In substance, this method represents an attempt to charge all purchases to the year incurred rather than to the respective periods of usefulness. Such a policy is usually employed where emphasis is placed upon budgeting and it is desired that the records reflect all expenditures for the period irrespective of their nature, and also where a supporting agency subsidizes the hospital. It is contended that records maintained in this manner will facilitate the comparison of the actual outlay with the related estimated budget.

However, as demonstrated below, these conveniences are not sufficient to right the wrongs inherent in the procedure.

Replacement treatment is contrary to correct accounting practice.

Correct acocunting practice requires that only those expenditures utilized during a financial year should be charged thereto. The balance should be deferred to the subsequent period of consumption. Under the replacement theory, the entire cost of the equipment acquired is charged to the period in which it was expended. Since capital expenditures usually involve substantial sums, the improper inclusion of such items in their entirety will distort the related financial statements. In consequence thereof, the affected reports will be ineffective for comparative purposes. Some merit may be attributed to the replacement policy if the amount of replacements were constant each year. However, in view of the considerable cost of fixed assets, the extent of their acquisition is usually determined by the availability of funds, as well as the necessity therefor. In addition, it is not customary for furniture and equipment to become obsolete with constant uniformity. Hence, it appears that financial statements which include the cost of capital replacements will not reflect the actual operating results for the respective periods.

Utilization of statements for fund raising.

The incorporation of replacements in financial statements may easily convert negligible operating losses to substantial deficits, thereby distorting the actual operating results. The utilization of such statements, prepared contrary to generally accepted accounting procedure, for purposes of fund raising represents a breach of public faith unless

the appeal for funds clearly states the purposes thereof.

Understatement of plant capital.

When capital outlays are charged to expense, the plant capital accounts will be maintained at static figures. The fixed assets of an institution will be reflected primarily at the amount of their initial purchase. Therefore, the values recorded on the books will bear no relation to the actual cost of the fixtures and equipment in use, which have replaced the original assets.

The principle of inventories conflicts with that of replacements.

Under the procedure of inventorying supplies on hand, the related expenditures are deferred to the period of utilization. However, under the replacement theory, the period of utilization is ignored, and capital purchases are charged to expense when procured. Hence, financial statements incorporating the application of both theories would, in substance, reflect a hybrid of cash and accrual accounting. Records maintained in this fashion would not represent good accounting practice and would not furnish a true picture of the operating results.

It is obvious that the practices of inventorying supplies and charging replacements to expense are contrary in principle. Yet, in spite of this apparent inconsistentcy, the supporters of the replacement theory advocate the policy of physical inventories. It would seem then that there is no logical explanation for charging capital replacements to expense.

Conclusion

The foregoing analysis of the opposing viewpoints does not reveal any mysterious ingredients in the nature of a hospital's fixed assets that should differentiate them from those acquired by commercial enterprises. Therefore, in my opinion, there is no reason why depreciation upon hospital plant and equipment should not be incorporated with operating costs.

AN ADIRONDACK VIEW

"If the mountain will not come to Mohammed, then Mohammed will go to the mountain." And so the Society came to the Adirondacks, to meet in convention at Saranac Inn. The majesty of the mountains, the tranquility of the lake and green fields, all were a harmonious setting for the papers read, the discussions, and the good fellowship.

A member read a learned paper on estate planning and added wisdom to great konwledge. One thought of those earlier estate planners, the settlers of the North Country. They, too, wanted great things to enjoy during their lives and the certainty that they could leave great things to their posterity, things of the spirit as well as things of this world.

In 1776, citizen soldiers returning from Montreal fought stubbornly on Lake Champlain. Settlers built boats for Commodore MacDonough in 1814, and fought for their homes around Plattsburg. Men came in 1917 to train for leadership in a great struggle then looming. Again in 1941. These mountains and these fields are the witnesses.

The member who spoke emphasized repeatedly that the personal well-being of the testator, his peace of mind and his desires, should prevail over the promptings of technical skills and that above all and to the end, the CPA must maintain his independence.

Surely, the settlers built well and we are heirs to their rich estates. Human dignity and personal freedom are ours.

ARTHUR BLAKE
of the Adirondack "Chapter".

Cash Discount

By Joseph A. Dowling

Traditionally, cash discount is considered to be an allowance, a reward for prompt payment of one's debts; realistically, it is a trade discount coupled with threat of penalty for not paying promptly. This may seem to be an academic nicety of no particular value: to distinguish between a reward and the avoidance of a penalty. Yet, the accounting result is much different depending upon which concept one recognizes, and so justifies an excursion into the nature and application of cash discount.

Some accountants consider cash discount to be financial revenue. In fact, it was at one time, perhaps still is to some extent, popular to associate it with interest earned, or interest paid. This affinity with interest is remote. Cash discount is really a charge computed at the rate of 36% a year (in a typical case). The 36% is derived from the common terms of 2% 10 days, 30 days net, which means that 2% is paid for the use of money for twenty days. 2% for 20 days is equivalent to the annual rate of 36%, or even 36.5% if you use all 365 days of the calendar year. Surely no one who can obtain bank credit would pay 36% interest for money. No, cash discount isn't financial income (when received) or financial expense (when allowed). Cash discount is simply a reduction of selling price to the seller, and a reduction of cost to the purchaser. When cash discount is denied because of lateness in payment, it is a penalty of 36% per annum (more or less, depending on actual terms), paid by those who are delinquent in settling their debts.

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The proposition herein stated is this: no accounting reports should ever show accounts for "Cash Discount Allowed" or "Cash Discount Received," but should show accounts for "Late Payment Penalty" in the company which loses the discount, and "Discount Penalties Collected" in the company which has the good fortune to collect the 36% penalty from its customers.

Cash discount ought to be deducted right on the face of a bill when it is typed, and some companies are doing this. When the sale is classified it should be stated for the net amount; in the hands of the payer the bill should be accounted for net and entered net in inventory, expense, fixed asset, or other appropriate classification.

To handle discount as financial income on books of buyer, gives the management of that company the false impression that shrewd financial administration yielded an impressive amount of additional revenue. What the management should know from its accounting department is the amount of discount it didn't get—that 36% penalty for lateness. In exposing that kind of information, the accounting department performs a useful service by inviting attention to a source of loss that needs managerial action.

For the company which allows the discount, the 2% (or whatever rate is allowed) is a reduction of the selling price and ought to be so entered in the books and statements. If it sells a variety of products and bills several kinds of material on one invoice, practical considerations of work effort may jus-

tify entering the discount as a deduction from gross sales without allocation to individual products; but if products are few, the discount should be deducted directly from the sales amount of each product. Direct application of discount gives a more accurate rate of gross profit.

When a bill is received by the purchaser, he may pay it at once to avoid the clerical labor of keeping an Accounts Payable sub-ledger, or he may set it up as Accounts Payable according to textbook practice. In the latter case, the true liability for any company which regularly pays its bills within the discount period (and that means most companies) is the net amount, the amount after discount. To state the Accounts Payable liability for the gross amount of purchases is to overstate the debts of the business. If it is asserted that discount isn't earned until the due date, the response must be that the penalty isn't incurred until after the due date has expired. Set up the liability net, and if bills aren't paid when due, then increase the liability by the amount of the penalty—but don't set up liability for penalties that the company does not intend to incur.

When the primary interest of this discussion is in the accounting of cash discount, there are income tax aspects which will invite the attention of income tax specialists. Common practice is to enter in Accounts Receivable subledgers the gross amount of each billing and then provide by allowance for cash discount, using the allowance account as a contra account to bring Accounts Receivable down to its net collection value. An allowance for cash discount is not deductible in computing taxable income. The experience of most companies will show that a very high percentage of customers (97% in a representative case within the experience of writer) will deduct cash discount; only a few will pay penalty of lost discount. Income tax should be assessed not on the gross sales but on the net sales, the amount more certain of collection. In effect, cash discount is deductible when the customer pays his bill and not before then. To pay tax on $100 this year (for a December sale) when only $98 will be collected in January, means advance payment of income tax on 2% of the company's sales. It is more logical to tax the net sale and later tax whatever penalty is actually received. Will the Internal Revenue Bureau allow discount as a deduction at time of sale if the net amount is entered in each customer's account (no allowance account used) and it is made clear on the invoice that a penalty (disallowed discount) will be demanded for late payment? Clearly, such action would be logical and appropriate to the circumstances.

Then there is sales tax. It is found that in a test group of 29 states having sales tax laws, 19 base the sales tax on the net amount, while 10 base the tax on the amount before cash discount. This indicates divided opinion (and perhaps some desire to get the most tax) as to which is the true amount of the sale. However, the majority, 65% of the states obviously consider the amount of the sale to be the amount after cash discount allowance. If more business firms issued their bills net, if more companies recognized in the billing and accounting practices, the true nature of cash discount (a reduction of the selling price), perhaps other states would join the ones which do not now demand sales tax on that part of the sale which (in most cases) will never be paid.

To summarize: Cash discount is not a windfall: it is a price reduction and a method of penalizing lateness. Accountants should recognize its true nature and base their accounting on that fact, not on the traditional and erroneous notion that cash discount is financial reward.

New York State Tax Forum

Conducted by BENJAMIN HARROW, C.P.A.

Increase in New York City Sales Tax Rate

The New York City sales tax was recently increased from 2% to 3%. The effective date was May 1st. The Comptroller was recently asked to rule on the applicable rate where a person had contracted for the purchase of goods before May 1st, delivery to be made after that date. The contractor argued that it would be inequitable to apply the 3% rate in his situation since his purchaser could not contemplate an increase in the sales and use taxes. The Special Deputy Comptroller ruled that the date of delivery determines the rate. Our law does not follow the practice followed in some jurisdictions of permitting a certain period of time to elapse for delivery after the effective date of an increase in rate, before applying the new rate in the circumstances.

In another ruling the Deputy Comptroller held that if delivery is made before May 1, 1950, the rate of tax is 2%, even though all or part of the purchase price is paid after May 1, 1950.

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Mr. Harrow has been a member of the American Institute of Accountants since 1922 and is a member of the New York Bar. He is now serving on the Society's Committee on Federal Taxation, and is Chairman of its Committee on State Taxation. He is also a member of the Institute's Committee on Federal Taxation.

Mr. Harrow is engaged in practice as a certified public accountant and attorney in his own office in New York City.

Pension Trusts

Under Sec. 365 (5) of the New York income tax law, pension trusts which are properly set up for the exclusive benefit of employees are not taxable on income earned. Amounts distributed or made available to an employee are taxable to the employee in the year of distribution or availability.

Under Sec. 165 (b) of the I. R. C., if a distribution is made entirely in one year it is taxable as a capital gain. There is no similar provision under our state law and since the definition of capital assets does not include distributions from pension trusts for employees, such distributions would probably be taxed as ordinary income. If an employee has contributed to the pension fund, only the distribution in excess of the contribution would be subject to tax.

Revocable Trusts

Under Section 166 of the I. R. C., distributable income from a revocable trust is taxable to the grantor and not the beneficiary. The State Tax Commission has always held that the beneficiary of the trust is taxable on such income, since there is no comparable statutory provision under New York law. Gain or loss on the sale of trust property is taxable to the trust as a taxable entity and not to the grantor under state law.

The Tax Court recently decided a case[1] where a settlor had created a revocable trust with herself as income

[1] 16 T.C., No. 53; February 26, 1951.

beneficiary and two daughters as successor beneficiaries. The settlor and one daughter died. Under the trust, the surviving daughter had a testamentary power of appointment over the corpus. During her lifetime the trustee was to pay the surviving daughter all the income and as much of the principal as the trustee deemed advisable for her comfort. The trust sustained a loss on the sale of some trust property and the daughter claimed a deduction for a capital loss. The Commissioner disallowed the loss to the daughter and The Tax Court upheld the Commissioner.

Under Section 22 (a), a settlor who retains powers of revocation and control over trust property is considered the virtual owner of the property and is taxable on the income. This principle has been held to apply to others than the grantor where the other persons have the power to appoint the corpus to themselves. In this case, the Court held that the daughter could not be considered as the owner of the corpus. Only the settlor had the power to revoke and that power died with her. The power to invade the principal required the independent judgment of the trustee. She did not therefore during her lifetime possess such control as would be equivalent to full ownership. That she had only upon her death. The Court felt that the separate taxable entity of the trust should not be disregarded.

The petitioner also took the position that since property subject to a power of appointment becomes part of the taxable estate for estate tax purposes, Congress must have intended such property to be part of the petitioner's estate for income tax purposes. The Court noted that such a consequence does not necessarily follow. It was too important a matter to be left for inference or conjecture. If Congress intended that interpretation it would have said so quite plainly.

Liability of a New York Trustee for California Inheritance Tax

The New York Supreme Court recently decided an interesting case[2] involving the right of the State of California to collect a state inheritance tax out of trust property located in New York. The trust had been created by the decedent during her lifetime. Income was payable to her during her life and she had reserved powers to modify or alter the trust. Under California law such a trust was includible in the net estate for estate tax purposes. The corpus of the trust consisted of specific personal property located in New York held by a New York corporate trustee.

The Comptroller of the State of California made a demand upon the New York trustee for payment of a portion of the California inheritance tax attributable to the trust by reason of its inclusion in the decedent's estate. The trustee made an application to the court for advice and instruction.

The Court held that the action of the Comptroller was against property of a resident located outside its state (an action *in rem*) and, therefore, California had jurisdiction against the property. It probably had no jurisdiction against the trustee *in personam*, unless the trustee subjected itself by consent to such jurisdiction. The courts of New York in a proceeding of this kind will apply the domiciliary law concerning apportionment. On the question of whether the trust property was taxable in California, our court held that the tax was proper. It therefore authorized the trustee to pay the tax out of the principal of the trust fund.

Interest on U. S. Bonds

In Report Bulletin 28 (dated June 11th) of their New York Tax Service, Prentice-Hall has an editorial comment on the taxability of interest on maturing series E, F and G bonds. The series E and F bonds were originally issued

[2] *Matter of City Bank-Farmers Trust Co. (Laughlin)*, Special Term, Part I, N.Y. L.J., April 5, 1951, p. 1231.

at a discount. In the year of redemption the difference between the redemption value and the cost is all taxable as interest under the Internal Revenue Code to the cash basis taxpayer. Such a taxpayer had the option to accrue the interest each year.

Under the New York income tax law the annual increment and the profit on redemption would be wholly exempt as interest on obligations of the United States. Under the franchise tax law such interest is, of course, included in determining entire net income and so is subject to the franchise tax. Technically, the franchise tax is an excise tax on the right to be and do business as a corporation. The entire net income is merely one basis for determining the excise tax.

On series G bonds interest is paid periodically. The interest is subject to tax under the I. R. C., but exempt under the state law. If the series G bond is cashed before maturity, the taxpayer receives less than the face value. This loss is dedubtible under the I. R. C. as an ordinary loss, but under state income tax law since it is deemed to be a repayment of interest exempt when previously received, the loss is not an allowable deduction. Under the franchise tax law the loss would be deductible in determining entire net income.

Deduction for State Income Tax

Suppose the Tax Commission has under examination the tax return of a taxpayer for the year 1948 and determines that an additional tax is due. This is paid in 1951. On the federal return when is the additional tax deductible? If the taxpayer is on the cash basis it is deductible in the year the tax is paid. On the accrual basis the tax is deductible for the year 1948, unless the tax is contested. In that event the tax is deductible when the contest is determined or payment is made before the determination.

Accrual of Salary Increase

In 1943, when wages and salaries were controlled, the directors of a corporation voted an increase in commissions of 20% to 25% to its salesmen. No attempt was made by the corporation to obtain government approval for the increase. After wage and salary controls were lifted in August, 1945, the corporation paid the increases to salesmen on 1943 sales and deducted the amount in 1945. The Commissioner held that the increase was not a proper deduction for 1945. If deductible at all the proper year was 1943. The Tax Court held[3] that no liability for payment of the increase accrued in 1943. Since government approval was necessary in 1943 before an increase in salary could be paid, there was no enforceable claim for the increase. There was merely an existing intention to incur such an obligation when the Stabilization Act was no longer in force. The year of payment is therefore the proper year for taking the deduction.

Entertainment Expenses

In a recent Tax Court case[4] a taxpayer claimed a deduction of $4,000 for entertainment expense. The amount was merely an estimate and not substantiated by records of actual disbursements. The Bureau disallowed the entire deduction. Before The Tax Court, the taxpayer was unable to show that any of his entertainment expenses resulted in new clients, nor could he separate his personal and business expenses. The Tax Court must have been convinced that he did incur such expenses in connection with his business and allowed a deduction of $1,000 as an estimate.

Early in the administration of the New York income tax law (April 27, 1922) the Tax Commission issued an official announcement on the subject of traveling and entertainment expenses. The Commission said that where the

[3] *Woodlawn Park Cemetery*, 16 T.C., No. 132.
[4] *Black*, T.C., Memo, March 12, 1951.

items exceed amounts considered normal for the particular business, the taxpayer will be required to substantiate the claim for the deduction. The announcement stated that the Income Tax Bureau "through experience gained in auditing returns in past years (sic!) knows the average or normal expenses of this character charged by merchants, salesmen, actors, etc., in different lines of business." If the deduction is normal the affirmation at the end of the return is accepted as proof of the claim. If the deduction is abnormal, the excess will be disallowed, unless the taxpayer produces either receipts or regularly kept books of account. The Commission will not accept mere estimates. As the Commission puts it, "if a taxpayer finds it more troublesome to keep books than to pay taxes based on normal expenses, he should not object if he is taxed according to the method in which he chooses to carry on his business." Evidence to substantiate deductions must be complete. That means, says the Commission, that the testimony must be of the type that would be accepted in a court of law as controlling evidence. The taxpayer should be prepared to undergo cross-examination under oath. "Hearings will not be accorded to taxpayers for the mere purpose of allowing them to hold forth upon the subject of their own honesty."

Franchise Tax on Real Estate Companies—Lien of Tax

The franchise tax is imposed on the right to do business as a corporation for the current calendar year or any part of it. The year commences on January 1st, even though the tax return is not due until March 1st. Sec. 197 of Art. 9 provides that the tax shall be a lien upon the real and personal property of the corporation until it is paid in full. The question has been asked as to when the lien first attaches: January 1st, when the privilege year starts; or March 1st, when the tax return is due. The Tax Commission has always held that the lien is imposed on the first day of the year, January 1st, prior to the payment date. This conclusion is based upon a Court of Appeals case[5] unanimously so deciding. However in a recent case[6] the Supreme Court, Special Term, Kings County, held that the lien for corporate franchise tax in the case of a real estate corporation attaches on the last day for filing the tax return (March 1) or upon such earlier date as the return might actually be filed. While the court attempted to reconcile this holding with the *Carey* case, there appear to be several points of difference which warrant further study and which will be commented on at greater length in a later article.

Head of Family

The proposed Revenue Act of 1951, adopted by the House of Representatives on June 22, revives the status of head of a family under the title head of household. The Ways and Means Committee felt that single taxpayers who are required to maintain a household for the benefit of other individuals are in a position similar to married couples, and that they should therefore receive some of the benefits of income splitting. A new surtax table is provided in the bill for taxpayers who qualify as heads of households. The surtax rates give such taxpayers approximately one-half of the benefits of income splitting.

A head of household is defined as an individual who is not married and who maintains a household in which he supports a dependent. The dependent must be a child or a descendent or one who is within the degree of relationship that qualifies for the dependency credit. In the latter category the dependent must not have a gross income of $500 or more. In the case of a child or its descendent, the gross income qualification does not apply if such persons are unmarried. The taxpayer must of course furnish more than half the main-

[5] *Carey* v. *Keith, Inc.* (1929) 250 N.Y. 216.
[6] *Ancel Realty Corp.* v. *Young*, 86 N.Y. Sup (2d) 754 (1949).

tenance costs of the household and the dependent must actually live in the household unless temporarily absent for reasons of health or because the dependent is away at school.

Under our state income tax law a head of a family receives the same personal exemptions as a married couple, $2,500. The regulations define a head of a family as one "who supports and maintains one or more individuals as a family unit who are closely connected with him by blood relationship, relationship by marriage or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation." (Reg. Art. 206)

Family Partnerships

The proposed Revenue Act of 1951 clears some of the confusion and uncertainty with respect to the recognition of family partnerships, in spite of the *Culbertson* case.[7] The definition of a partner is amended by adding the following: "A person shall be recognized as a partner for income tax purposes if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived *by purchase or gift* from any other person."

In determining the distributive share of a partner who receives his capital interest by gift, the partnership agreement must provide a reasonable compensation for services rendered to the partnership by the donor. Also, the distributive share attributable to donated capital may not be proportionately greater than the share attributable to the donor's capital. Absence of a partner due to military service shall not be considered in determining a partner's share in the earnings of the partnership. The new provisions will be effective after December 31, 1950.

The purpose of the new provisions is to make clear two tax principles. The first is that income from property is attributable to the owner of the property. The second is that income from services is attributable to the person rendering the services. It is the intention of Congress to recognize a gift of a family partnership interest without regard to the motives actuating the gift. The new provisions are in line with earlier decisions of The Tax Court before the *Tower* case.[8]

The Tax Commission will probably follow the new proposals if they should be enacted.

Gain from Sale or Exchange of Taxpayer's Residence

The proposed Revenue Act finally attempts to eliminate in part the inequity in taxing a gain resulting from the sale of a residence. Such a gain will not be recognized if the taxpayer purchases a new residence within the period of one year prior to the date of such sale or one year after such sale. To the extent that the selling price of the old residence exceeds the cost of the new residence, the gain will still be taxed. A loss will remain non-deductible. The new provision will apply only to the principal residence of a taxpayer. Where part of a property is used as a residence and a part for business purposes, an allocation will be required to determine the portion of the gain that will not be taxed. Stock held by a tenant stockholder in a cooperative apartment will likewise come within the new provision. In determining the selling price of the old residence, commissions and other selling expenses are not to be deducted. However the cost of the new residence includes commissions and purchasing expenses. Where a gain is not recognized, the basis of the new residence must be reduced by the amount of the unrecognized gain.

Under the State income tax law a gain on the sale of a residence is taxable as a capital gain; a loss is deductible as a capital loss. With the advent of the proposed change in the federal law we may expect an early change in the state law along similar lines.

[7] 337 U.S. 733.
[8] 327 U.S. 280.

Office and Staff Management

A forum for the exchange of views and information on all aspects of the administration of an accounting practice.

Conducted by MAX BLOCK, C.P.A.

New York State Merit Rating Plan

Accountants have another opportunity to render a valuable service to clients in the revised New York State unemployment insurance tax on employers and the merit rating plan thereunder. Employers should be informed of the significance of the merit rating plan and what it might mean to them in dollars.

They should be advised to check the validity of all claims for benefits, and be informed on the legal grounds for refusal of benefit payments. This is necessary to keep employees who are not entitled under the law to any benefits from obtaining them. The payment of unwarranted benefits unnecessarily reduces the employer's merit rating credit and is socially unsound. Furthermore, they should be urged to respond to all requests by the Department for information within the prescribed 7 day period, thereby avoiding the $10 penalty and, perhaps in addition, improper charges to their accounts.

Staffs should be advised to familiarize themselves with the revisions which, for employers, became effective July 1, 1951, and to determine that clients are familiar with the new requirements and provisions, and that they have the right "tools" for compliance in the way of adequate control records.

Sick Pay and Overtime Exemption

Office and staff managers should be mindful of the ruling of the Wage-Hour Division, reported by the various tax services, concerning deductions on account of illness from salaries of employees who, because of their professional status, are exempt from the overtime rule.

In its opinion the Division held that deductions for illness during part of a week from salary of an overtime-exempt employee will void the exemption. But if it is the firm's policy not to pay salaries for any week in which no work is done, the exemption will not be lost. In brief, part pay for a week will create a problem, no pay does not.

A pitfall for an unwary employer lies in the deduction from an employee's salary of the amount of New York State Disability Fund benefits. Such policy is followed by some employers who take the position that disability insurance collections are a substitute for salary. However, if the deduction covers part of a week's salary, and an overtime-exempt employee is involved, the policy of making such deductions will cause a loss of the exemption privilege.

The same rule applies to executive and administrative employees. It is the Division's view that the classification of such exempt employees requires a full week's pay if any work is done during the week.

Summary of Topics Discussed at Meeting of Accountants' Office and Staff Managers on June 26, 1951

General topics of discussion at the meeting were as follows:

Wage and Personnel Problems

Views were exchanged on firm policies in connection with the frequency of salary discussions with staff personnel, compliance with Wage Stabilization Board regulations on salary increases, and policies concerning the hiring of personnel employed by other accounting firms at the time of interview.

Tax Control Records

The question of systems employed for tax return control and follow-ups stimulated great interest. Various card systems of "tax-ticklers" were described.

O.P.S. Reports

There was a general discussion of the extent of services rendered to clients by accountants in connection with compliance with O.P.S. Regulations and preparation of reports.

Staff Education

Various methods used by representative firms for disseminating to staff personnel current information on taxes, O.P.S. Regulations, Wage Stabilization, and general accounting procedures were presented. These methods include the following:

1. General staff meetings for coverage of specific topics such as Excess Profits Taxes, Wage Stabilization, etc.
2. Routing of weekly or periodical standard service reports to staff for reading.
3. Required reading by staff of current accounting periodicals and bulletins of the American Institute and the New York State Society.
4. Preparation of bulletins on taxes and government regulations by partners or firm tax department for distribution to staff personnel.

Control of Tax Returns

There is a wide variety of devices and procedures in use to control the timely preparation and forwarding of tax returns. Each has its distinctive appeal to the user and undoubtedly serves him well.

For the benefit of accountants who may be grappling with this problem there is submitted a description, with forms, of the method employed by a New York City accounting firm.

"Our system in which these enclosures are utilized operates as follows:

"When a new client is acquired, the basic information required for the setting up of the tax control cards is submitted. This includes name and address, type of entity, date of formation, state in which organized, foreign state in which taxpayer may be operating, and the principals for whom personal income tax returns will be filed.

"Varied-colored crimped signals are then inserted over the month of the 'business tax card' (Figure 1), each representing a different date, e. g.,

Tan—Date of tax closing
Purple—Last possible date for tax closing (new companies only)
Red—Due date of N. Y. franchise tax
Green—Due date of foreign state tax returns
Blue—Due date of N. Y. C. gross receipts tax

"By consulting our Kardex file, we then prepare a monthly schedule of all tax returns due for a specific date simply by scanning down the particular month and recording in accordance with the color code. The progress and status of any return is noted on this monthly schedule as it passes through the various stages of preparation. The schedule also serves as the basis for posting to the card the date that the return was mailed or delivered to the client.

"The 'personal tax card' (Figure 2) is visible whenever the file is opened to the 'business tax card' and the information recorded thereon requires no explanation. The personal income tax assignments are made from this card, and at that time, the auditor responsible for the preparation of the return is apprised of any unusual deductions which may be noted in the available space, especially interest paid on income tax assessments which, from our experience, have often been overlooked by the taxpayer when submitting his deductions.

"This system was devised more than four years ago, and has suited our basic needs admirably. Some modification in the form will probably be made when our present supply is exhausted, since the actual operation of the system revealed the omission of a few minor items."

FIGURE #1

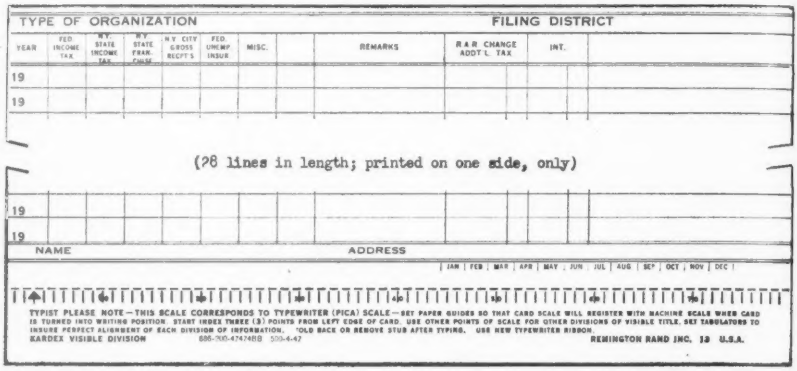
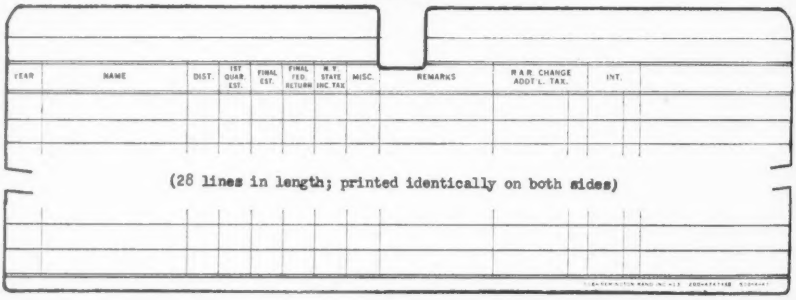


FIGURE #2



The Excess Profits Tax Exchange

Conducted by DAVID ZACK, C.P.A.

THIS column is a clearing house for questions, problems and comments regarding Excess Profits Taxes. Items of general interest will be published herein and full credit will be given all contributors unless they request otherwise. All inquiries and contributions should be addressed to:

Editor, The Excess Profits Tax Exchange
The New York Certified Public Accountant
677 Fifth Avenue
New York 22, N. Y.

Abnormal Deductions

A new member of the Society makes the following inquiry concerning abnormal deductions:

"I would like to pose three questions regarding excess profits taxes.

(1) Referring to section 433 (b) (9) and (10): A corporation paid $10,000 for a settlement in a casualty case in 1948. The corporation had a similar deduction in 1947 (for $3,000) and, also, one in 1950, for $2,000. The corporation is in existence since January 1, 1940 and files on a calendar year basis. In no other years of its existence did it have any similar deductions.

Question: How would you calculate the the abnormal deduction?"

Section 433(b)(9) and (10) provide for the partial or total disallowance of certain classes of so-called abnormal deductions in the determination of the excess profits net income for any year in the base period. However, the law provides certain limitations on the disallowance of these abnormal deductions. Some of these obstacles are subjective and others are reduced to specific arithmetical formulae.

In every case, and in accordance with the World War II statute, the burden is on the taxpayer to establish that the increase in the alleged abnormal deductions is not a cause or a consequence of an increase in gross income or a decrease in the amount of some other deduction in the base period, which increase or decrease is in substantial relation to the amount of the increase in deductions. The taxpayer must also prove that the increase in the deductions is not a consequence of a change at any time in the type, manner of operation, size, or condition of the business engaged in by the taxpayer. (Section 433(b)(10)(c)).

The specific limitations set forth in the code are as follows:

(1) *"115% Rule*—Only the excess over 115% of the average amount of 'abnormal' deductions of a particular class for the four previous taxable years may be disallowed. (Sec. 433(b)(9)). If the taxpayer was not in existence for four previous taxable years, then the average amount of deductions is computed for such years as it did exist and the succeeding taxable years which begin before the beginning of the taxpayer's second taxable year under the Excess Profits Tax Act. If the number of such succeeding years is greater than the number necessary to obtain an aggregate of four taxable years, so many of such succeeding years are omitted, beginning with the last, as are necessary to reduce the aggregate to four. (Sec. 433 (b)(10)(A))."

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Mr. Zack is a member of the New York Bar, the Federal Bar, and the Tax Bar. He is a Lecturer on Taxation at The City College (N. Y.) School of Business and Civic Administration where he developed an intensive course on the New Excess Profits Tax Act.

Mr. Zack has written on tax matters for various publications. He is engaged in tax practice with a prominent New York firm of certified public accountants.

(2) "*5% Rule*—The burden is on the taxpayer to prove that the 'abnormal deductions' as to any class exceed 5% of the average excess profits net income for the taxable years within the base period computed without the disallowance of any class. (Sec. 433 (b)(10)(B))."

(3) "*Current Year's Limitations*—The abnormal class of deductions to be disallowed for any taxable year must not exceed the amount by which the deductions of that class for that year exceed the deductions of the same class for the taxable year for which the excess profits tax is being computed. (Sec. 433(b)(10)(D))."

Since the question does not give the excess profits net income for each of the years it is impossible to apply the 5% limitation. In this connection it should be noted that the average excess profits net income is computed by adding the excess profits net incomes for all the applicable taxable years, dividing the aggregate by the total number of months in such years, and multiplying the quotient by 12. For this purpose, the excess profits net income for any taxable year is not regarded as less than zero. (Sec. 433(b)(10)(B)).

Interest Adjustment with Minimum Credit and Relief Provisions

The member's second question reads as follows:

(2) "Do you make any adjustment for interest on line 2 where you use the $25,000 minimum credit or the credit under any of the relief provisions (sec. 442-446)? I have made inquiries and find this problem very controversial among accountants."

The computation of the interest adjustment when the minimum credit is used was pointed out in detail in the April, 1951, issue of this column. Sections 442 to 446 are merely alternative means of computing average base period net income (Sec. 435(c)). Section 433(a)(1)(O) requires that the specified interest adjustment for the current excess profits tax year be made whenever the excess profits *credit* is computed under Section 435 and that would appear to be the situation whenever any of the so-called relief sections (Sections 442-446) are applied in order to determine average base period net income.

New Corporations

The third question propounded by our new member reads as follows:

(3) "Where you determine your credit under section 445 (new corporations) for 1950, may such credit be used for all future excess profits tax years? Isn't it also extremely advantageous for such corporations to borrow or increase their capital stock issues during such years?"

The credit determined under Section 445 varies after the completion of the first three excess profits tax years. (Sec. 445(b)). The credit for the first three years under Section 445 is based on total assets on the last day of the last pre-excess profits tax year so that borrowing would provide no particular advantage. Increased capital investments would of course increase the net capital additions and thereby increase the excess profits tax credit.

Inequities in the Law

Abraham J. Briloff, C.P.A., points out the following inequities in the Excess Profits Tax Act which might well be corrected by changes in the law or regulations, or both:

"There are two incongruities contained in the Excess Profits law which I believe might well be pointed up:

"Incongruity #1 refers to situations where the tax is computed without reference to the excess profits credit under the income or invested capital method. This situation arises in instances where the tax is based on the excess profits income after deducting the minimum $25,000 credit, and also arises in situations where the 62% limitation is applicable. The inequity is that the Regulations would require the adding back of 75% of the interest on borrowed capital, even though in both of the situations the borrowed capital does not affect the tax liability one iota.

(Continued on page 584)

The 111th New York Certified Public Accountant Examination

MAY 16, 17 AND 18, 1951

THEORY OF ACCOUNTS

Thursday, May 17, 1951—9 a. m. to 12.30 p. m., only

This paper is intended to test the extent of your knowledge of accounting theory and your ability to apply the knowledge you have acquired. Due weight will be given to the arguments presented to support your answer to each question, even though the examiners may not agree with your conclusions.

Group I—Answer all questions in this group.

1 [12]

The H Manufacturing Company is engaged in manufacturing items to fill specific orders received from its customers. While at any given time it may have substantial inventories of work in process and finished goods, all such amounts are assignable to firm sales orders which it has received.

The company's operations, including the administrative and sales functions, are completely departmentalized. Its cost system is on a job order basis. Direct materials and direct labor are identified with jobs by the use of material issue tickets and daily time cards. Overhead costs are accumulated for each factory service, administrative and selling department. These overhead costs, including administrative and selling expenses, are then allocated to productive departments and an overhead rate computed for each productive department. This rate is used to apply overhead to jobs on the basis of direct labor hours. The result is that all costs and expenses incurred during any month are charged to the work-in-process accounts for the jobs.

a You are to compare this system, as it affects inventory valuation, with the usual system for manufacturing businesses.

b You are to criticize the system as it affects inventory valuation and income determination.

c You are to state any justification which you see for the use of the H Company's system.

2 [12]

Because of its large volume of business, the Hall Company is operating its plant 70 hours a week instead of the 35 hours a week which it usually operates. The company computes depreciation on a straight-line basis. Because of the increased rate of operation, the treasurer has suggested that depreciation rates should be doubled.

Discuss this suggestion of the treasurer, including a full discussion of the factors that should be considered by thte company in determining rates of depreciation. Do not consider income-tax effects.

3 [8]

The ABC Partnership is a general construction contractor engaged in constructing residences and small stores under firm price contracts. The partnership has underway, on December 31, 1950, ten contracts, each of which is 80% completed. The partnership

follows the "completed contracts" basis of accounting, under which gains or losses on contracts are recognized only upon completion of the contract and acceptance by the customer. As of January 1, 1951, the partnership is to be converted into a corporation, with A, B and C as the sole stockholders. It is proposed to continue the use of the "completed contracts" basis in the corporation and to transfer contracts in process from the partnership to the corporation at book value without recognition of gain or loss to December 31, 1950, subject only to normal year-end adjustments.

Discuss the propriety of this proposal from the accounting point of view, with special reference to its effect on a proper showing of profits in both the partnership and its corporate successor. Do not discuss income-tax effects.

4 [8]

For some time Mr. Friend has operated a small grocery. He has limited his accounts to single-entry records and has engaged outside assistance only for preparation of his tax return. He has never needed to obtain credit and does not expect to need to do so, Mr. Friend approaches you with the statement that he has heard of "double entry" and would like to know what benefits, if any, he would derive from the use of such a system.

Prepare a brief statement of the advantages to Mr. Friend of using double-entry bookkeeping, and also indicate the disadvantages, if any.

5 [10]

Accountants frequently refer to a procedure as being "conservative." Explain what is meant by "conservative" accounting procedures. Discuss the question of the extent to which it is possible to follow accounting procedures which will result in consistently conservative financial statments over a considerable number of years.

Group II—Answer any four questions in this group.

6 [12½]

The December 31, 1950, balance sheet of a medium-sized manufacturing corporation did not include the following items among the current liabilities. (All are material in amount.)

a Notes payable fo a group of twelve stockholders, the notes to become due and payable on demand of at least eight of the group.

b A note due March 31, 1951, in settlement of which the holder accepted preferred stock on January 6, 1951.

c Rent collected in advance.

For *each* of three items above, you are to give arguments to justify the exclusion from current liabilities. If your answer involves assumptions as to facts not given in the question, state your assumptions.

7 [12½]

A golf club constructed a club house at a cost of $100,000. It was financed by a $100,000 bond issue, the funds being furnished by various members. The bonds are due in 50 years and are to be called by lot at the rate of $2,000 a year. A 2% depreciation rate is considered to be proper. You are asked by the directors of the club to advise them as to whether the provision for the $2,000 annual reduction of the bond issue, the annual depreciation of $2,000, or both, should be included in the budget to be covered by club dues and green fees. Explain the effect of the various alternatives.

8 [12½]

The published report of a corporation was criticized because it was claimed that the income statement does not by any means give a clear picture of annual earning power and that the balance sheet does not disclose the true value of the fixed assets.

Considering the criticism made, you are to prepare an explanation of the nature and purpose of the income statement and of the balance sheet, including an explanation of their limitations.

9 [12½]

The P Corporation has made substantial advances of cash to S Corporation, its wholly owned subsidiary. S uses some of the cash to purchase a block of P Corporation stock in the open market. S also issues some of its own stock, which it sells to P, using the cash received to repay the advances received from P.

You are to give your opinion of *each* of the following practices:

a The stock of P owned by S is shown as an "Investment" on the consolidated balance sheet of P and S.

b Dividends on the stock of S are shown as a nonoperating income on the income statement of P.

c The total of dividends declared but not paid on the stock of P are shown as a current liability on the consolidated balance sheet of P and S.

10 [12½]

a Discuss the question of the date on which real estate taxes should be considered to accrue for financial statement purposes, including in your discussion some consideration of the amount that should be charged to the income account of any year.

b State the federal income-tax rules as to accrual of real estate taxes.

c A Manufacturing Company uses a different tax period over which property tax is accrued on its books from that which it must use in preparing its federal tax return. Describe the adjustments necessary on the return, illustrating with figures from an assumed case.

COMMERCIAL LAW

Friday, May 18, 1951—9 a. m. to 12.30 p.m., only

Reasons must be stated for each answer; no credit will be given for an answer unsupported by a statement of reasons. Whenever practicable, give the answer first and then state reasons. Answers will be graded according to the candidate's evident knowledge of the legal principles involved in the question rather than on his conclusions. Answers to questions involving negotiable instruments, partnerships and sales should be based on the provisions of the pertinent Uniform Law.

Group I—Answer all questions in this group.

1 [10]

a Name and describe *four* important rights of a shareholder in a corporation.

b After a dividend has been declared, but before it has been paid, are the shareholders secured or unsecured creditors? Explain.

c What is meant by a stockholder voting by proxy?

d Name *three* circumstances under which a dividend may be revoked.

2 [10]

B purchased from S two piles of lumber at $70 a thousand feet, the contract being silent as to when title was to pass. B was to load the lumber and truck it away within the next three months, paying for each quantity trucked away within thirty days from the date it was taken.

a If one of the piles of lumber is destroyed by fire before delivery must B pay for it? Why?

b Shortly after the contract was made, B sold the lumber to T for $85 a thousand, T paying B in cash for it. T sought to haul the lumber away but

S refused to let him take it. Under what conditions, if any, has S the right to deny delivery to T?

c Assume B failed to take any of the lumber within five months following the sale and at the close of the fifth month, S resold it to X at $90 a thousand. Must S account to B for the $20 a thousand excess?

3 [10]

A sold a refrigerator to B and accepted B's negotiable promissory note for $600 in payment. The note was payable to A's order one year after the date of issue. Thirty days later, A indorsed the note with a blank indorsement and sold it to P Bank for $550. P Bank credited A's checking account with that amount, which brought A's balance to $725. A drew checks for a total of $675 which P Bank honored. The bank then learned that the refrigerator had not been delivered by A. The note is now due and unpaid. B pleads lack of consideration for the note when sued by the bank.

a Would B's defense hold against P Bank if P Bank were a holder in due course?

b Is P Bank a holder in due course?

c Assume that P Bank is a holder in due course. How much would you allow P Bank to recover from B on the note?

4 [10]

a C contracted to build an office building for O according to agreed specifications at a cost of $190,000. At a later date C discovered that he had made a $15,000 error in his calculations. Before work starts, may he have his contract recinded because of this mistake?

b Assume in *a* above that no error had occurred, but that, prior to the beginning of construction, material costs increased $20,000. If O promised in writing to pay that additional amount at the date of completion of the building, is the promise enforceable?

c If O leases to T a suite of rooms in a proposed new building at $130 a month, the lease to begin on October 1, but the building is not available for occupancy until December 1, is O liable in damages to T?

5 [10]

a What warranties may a properly appointed agent make to third parties in connection with title in a sale of personal goods?

b (1) When must an agency relationship be created by a written instrument? Why?

(2) Name and describe *one* instance where the agent's authority must be in writing.

c Name *four* situations which may terminate the authority of the agent by operation of law regardless of the consent or intention of the parties to that relationship.

Group II—Answer any five questions in this group.

6 [10]

a On March 15, 1948, B was adjudicated a bankrupt. On January 10, 1948, B had given to C a chattel mortgage on his delivery equipment to secure a past-due $4,000 obligation which he owed to C. Assuming the mortgage was promptly recorded but that T, the trustee in bankruptcy, desires to avoid the mortgage and treat C as an ordinary creditor, has he the right to do so? Why?

b Is insolvency of a debtor an act of Bankruptcy?

c What is the purpose of involuntary bankruptcy as distinct from voluntary bankruptcy?

d B grossly misrepresented to C merchandise which he sold to the latter. Shortly thereafter B became a bankrupt. C was permitted to file a claim for $500

for the amount of loss sustained, but actually received only 20% dividend from the bankrupt's estate. A year after he received his discharge B inherited some property and C desires to collect the remaining $400. May C collect the remaining $400? Explain.

7 [10]

a Identify and distinguish between a straight bill of lading and an order bill of lading.

b A shipped a carload of furniture over the M railroad. The railroad issued a bill of lading to the order of A. B stole the bill, indorsed A's name on it and sold it to C, an innocent purchaser, for value. M Railroad surrendered the furniture to C when C produced the bill of lading. Did C have title to the furniture? Explain.

c T, employee of X Railroad, issued an order bill of lading to his friend, B. The bill purported to cover a carload of scrap iron shipped over X Railroad. Actually no iron was shipped although T's duties included the issuance of bills of lading for the railroad. B indorsed the bill and sold it to P, a bona fide purchaser, for value. Can P hold X Railroad liable? Why?

8 [10]

S and T, by separate contracts with B, agreed to act as sureties for A who had borrowed $5,000 from B. A also pledged bonds worth $4,500 with B as additional security for the payment of the debt. The debt is now due and unpaid. Give short, explanatory answers to the following questions:

a In the event B now wishes to recover the amount of the debt from S and T, may he do so without first selling the bonds?

b Suppose that A paid $4,000 and B applied the payment on an earlier unsecured debt owed B by A. Could B hold S and T for the $5,000 debt in full if A had said nothing as to which debt he was paying?

c If B should extend the debt thirty days by valid contract with A, are S and T relieved of liability, assuming no knowledge or consent on their part of the extension agreement?

d Would S be liable for the total $5,000 debt to B if B saw fit to ignore T and sue S for the full amount?

e Assume that B could hold S for the full amount. Has S any recovery against T, if nothing is said about recovery in the suretyship agreements?

9 [10]

L leased a room in a business building to T for five years at $600 a month for use as a restaurant.

a If the lease is oral but T spent $4,000 for improvements, took possession and paid rent for three months, may L terminate the lease?

b If the lease is written, but T's business is quite poor during the second year, and L promises to accept during the remaining four years $400 each month in full payment of the rental, and each month gives a receipt in full for that month's rental, may L later recover the $200 a month shortage?

c Assume the lease was written and that L had told T the measurement of the room was 90 feet by 58 feet, whereas it was 75 by 50. May T have the lease rescinded if L made the statement in good faith? Assume T had not taken possession.

d If, in negotiating the written lease, L knew that a nearby business which employed 1,500 people accustomed to eating lunch in the neighborhood was about to install a cafeteria for its own employees but said nothing of this to T, may T have the lease avoided because of fraud?

10 [10]

a When and how may a valid offer to contract be revoked (withdrawn)?

b Describe *one* situation under which an offer, once made, may not be revoked.

c A certified public accountant desiring to retire from practice sells his business, including Goodwill. As part of the contract of sale, he agrees not to engage in the practice of public accounting for ten years. Is such an agreement enforceable?

d An employee desires to terminate employment under a contract which has two more years to run. His employer indicates that he would be willing to acquiesce in such termination if the employee will agree not to seek similar employment with another firm. Under what circumstances would this agreement be enforceable?

11 [10]

The following statements are based on the Uniform Partnership Act. On your paper you are to list the letters *a* through *j*. Opposite each letter you are to write the word "true" if the statement is true or the word "false" if the statement is untrue. Grade will be based on the number of correct answers. No reason need be given to support your answer.

a A partnership is dissovled when any partner withdraws from the partnership.

b The sale or assignment of his interest in the partnership by one partner will dissolve a partnership.

c Bankruptcy of either the partnership or of an individual partner will dissolve a partnership.

d Even though a partnership agreement is, by its terms, to exist for 5 years, any partner may dissolve the partnership by withdrawing at the end of the second year.

e When a partnership is dissolved, all third parties who have not dealt on credit with the partnership in the past, are deemed to know of the dissolution.

f When a new partner is admitted into an existing partnership, the business may be continued without liquidation of the affairs of the previous partnership but the former partnership is dissolved.

g Creditors of the new partnership (see *f* above) have rights to all of the assets of the new partnership, the creditors of the former partnership having no rights against such assets.

h A new partner who is admitted to an existing partnership is personally liable for all debts of such partnership, incurred before his entrance into the partnership.

i When a partner withdraws from a partnership, he remains personally liable for debts of the firm incurred before his departure from the partnership.

j Upon the death of a partner, his right in specific partnership property, including real estate, vests in the surviving partner or partners to the exclusion of the deceased partner's widow or heirs.

12 [10]

The following statements are based on the Uniform Negotiable Instrument Act. On your paper you are to list the letters *a* through *j*. Opposite each letter you are to write the word "true" if the statement is true or the word "false" if the statement is untrue. Grade will be based on the number of correct answers. No reason need be given to support your answer.

a An instrument which stipulates no maturity date is nonnegotiable.

b An instrument which calls for a principal sum with interest but which stipulates no rate of interest, may be negotiable.

c An instrument payable on a contingency may be negotiable if the stipulated event occurs.

d An instrument payable on an event which is bound to happen, such as death, may be negotiable.

e If the holder of an instrument may elect to require the maker to do something in lieu of paying money, the instrument may be negotiable.

f If an instrument fails to specify the value for which it is given, it is not negotiable.

g If an instrument is payable to "cash or order" it is not negotiable.

h An instrument payable to the order of a designated payee becomes bearer paper when the payee indorses it in blank.

i An instrument will be negotiable although it stipulates no place of payment.

j An instrument issued on July 1, 1950, which states that July 10, 1950, is the day of issue, is not negotiable.

AUDITING

Friday, May 18, 1951—1.30 to 5 p. m., only

Answer all questions. Credit will be allowed not only for accuracy of answer but also for technic.

1 [10]

You are engaged in making the audit of a corporation whose records have not previously been audited by you. The corporation has both an independent transfer agent and a registrar for its capital stock. The transfer agent maintains the record of stockholders and the registrar checks that there is no overissue of stock. Signatures of both are required to validate certificates.

It has been proposed that confirmations be obtained from both the transfer agent and the registrar as to the stock outstanding at balance-sheet date. If such confirmations agree with the books, no additional work is to be performed as to capital stock.

If you agree that obtaining the confirmations as suggested would be sufficient in this case, give the justification for your position. If you do not agree, state specifically all additional steps you would take and explain your reason for taking them.

2 [10]

Your client, who sells on credit, has several bank accounts. A reconciliation of one of these accounts as of the balance-sheet date appears as follows:

Balance per bank, December 31, 1950	$5,000
Add—Deposit in transit	1,000
Total	$6,000
Less—Outstanding checks	50
Balance per books, December 31, 1950	$5,950

The book balance of $5,950 is shown as cash on the balance sheet.

As to the $1,000 shown as a deposit in transit, you are to:

a Briefly describe the major possibilities of fraud or error.

b List the audit procedures that might be followed in a regular annual audit which would help to verify the deposit in transit. Explain fully how these procedures would help to verify the deposit in transit and detect possible fraud or error.

3 [12]

The partnership of Allen & Bask was formed April 1, 1949. Their capital contributions were: Allen $25,000 in cash; Bask $25,000, consisting of the assets listed below:

	Fair Value Apr. 1, 1949	*Acquired by Bask* *Date*	*Cost*
Land	$ 2,400	1945	$ 2,400
Building	18,000	1945	18,000*
American Products Corp.—10 shares	2,080	1949	1,150
U. S. Treasury 2% bonds, $1,000 face amount	1,020	1939	1,000
City of Nash, Ohio, 4% bonds, $1,500 face amount	1,500	1939	1,475
	$25,000		

* Cost $20,000 less depreciation to April 1, 1949 on a 40-year life.

The agreement provides for interest on original capital at 4% per year, an annual salary to Allen of $5,500 and the balance of profit or loss including all gains or losses to be divided one-third to Allen and two-thirds to Bask.

During the year ended March 31, 1950, the interest and $4,000 of Allen's salary were paid. Operations, as they were recorded in the accounts, are summarized below:

Income:	
Sales	$50,000
Profit on sale of land and building on June 30, 1949	4,550
Dividends on American Products Corp. stock	15
Interest on U. S. Treasury bonds	20
Interest on City of Nash, bonds	60
Total income	$54,645
Costs:	
Cost of goods sold	$30,660
Loss on sale of 10 shares American Products Corp. May 15, 1949	180
Office salaries	2,170
Taxes	1,300
Misc. administrative and selling expense	2,800
Contribution to community chest	80
Rent—after land and buildings were sold	1,800
Depreciation on building	125
Depreciation on furniture and equipment	530
Partners' salary	4,000
Interest on capital	2,000
Total costs	$45,645
Profit	$ 9,000

Submit a summary of the data to be reported in Schedule I (Partners' Shares of Income and Credits) of the Federal partnership return for the year ended March 31, 1950. Your supporting computations should be clearly presented.

4 [7]

One of your new clients values inventory by a procedure which you have not previously seen used by any company. In order to avoid a qualification in your report, you wish to determine whether or not that procedure is in accordance with generally accepted accounting principles. Explain how you would determine the acceptability of the procedure.

5 [12]

a In auditing practice, confirmation of accounts payable is less common than confirmation of accounts receivable. Give reasons why this is so.

b Prepare a confirmation request for notes payable.

6 [7]

In the making of annual audits there has been a trend away from the detailed checking of the accuracy of postings from books of original entry to the ledgers. Explain why this has occurred. State what procedures other than the checking of postings can give the auditor assurance as to the correctness of the postings and explain how they are effective in eliminating the need for detailed checking of postings.

7 [16]

In 1949, Clar Chemical Corporation developed a new product with great potentialities as a building material, and a contract was signed with Paulin Manufacturing Company, Inc. to develop a commercial production process. Under the contract, Clar Chemical advanced $100,000 on October 1, 1949, to cover estimated development costs. These costs were defined as direct labor and direct material plus 25% of these direct costs to cover overhead. No profit was allowed, but when a successful process is developed Paulin Manufacturing is to be licensed to manufacture the product.

The contract calls for monthly progress reports and a monthly statement of costs charged against the advance. Officials of Paulin Manufacturing Company have carefully abided by the terms of the contract. However, because they believed the $100,000 advance was not an asset of Paulin Manufacturing Company, they deposited it in a special account which was not in their regular depository, and made no entry on the books of the company.

At the end of each month, time cards and material requisitions were analyzed and the costs applicable to this contract were accumulated on the required monthly statement, but no entry was made on the company's books. A check was then drawn on the special account and deposited in the regular account as a cash sale for the amount shown on the statement.

At December 31, 1949, the unexpended balance of the special account was $43,750, but the check for December costs of $20,500 was not drawn until January 5, 1950. On January 10, 1950, you commence an annual audit of Paulin Manufacturing Company, Inc. for the year ended December 31, 1949.

a Give all procedures by which you might discover the existence of the contract.

b If you discover the existence of the contract, what auditing procedures would you follow in connection with the contract?

c How should the information about balances or transactions in connection with the contract be shown on the balance sheet?

8 [18]

The Witt Company is engaged in manufacturing. Certain features of its operating methods are described below.

You are to consider the procedure for each of the activities as described and point out the existing deficiencies, if any, in internal control, including an explanation of the errors or manipulations which might occur in view of the weakness and your recommendations as to changes in procedures which could be made to correct the weakness.

a When materials are ordered, a duplicate of the purchase order is sent to the receiving department. When the materials are received, the receiving clerk records the receipt on the copy of the order, which is then sent to the accounting department to support the entry to accounts payable and material purchases. The materials are then taken to stores where the quantity is entered on bin records.

b Time cards of employees are sent to a tabulating machine department which prepares punched cards for use in the preparation of payrolls, payroll checks and labor cost distribution records. The payroll checks are compared with the payrolls and signed by an official of the company who returns them to the supervisor of the tabulating department for distribution to employees.

c The company has an employee bond subscription plan under which employees subscribe to bonds and pay in installments by deductions from their salaries. The cashier keeps the supply of unissued bonds in a safe together with the

records showing each employee's subscription and payments to date. The amounts of unissued bonds in the hands of the cashier and the balances due from employees are controlled on the general ledger, kept in another department. However, the employees may, if they desire, pay any remaining balance to the cashier and receive their bonds.

When an employee makes a prepayment, the cashier notes the amount on his account, delivers the bond and receives a receipt from the employee for the amount of the bond. The cashier deposits bond cash received in an employee bond bank account and submits a report showing the transaction to the general ledger department; this report is used as a basis for the necessary adjustments of the control accounts. Periodic surprise counts of bonds on hand are made by independent employees, who check the amounts of unissued bonds and employees' unpaid balances with the control accounts.

During the cashier's lunch hour or at other times when he is required to be absent from his position, another employee, with keys to the safe in which unissued bonds and employee bond payment records are kept, comes in and carries out the same procedures as enumerated above.

d A sales branch of the company has an office force consisting of the manager and one assistant. The branch has a local bank account which is used to pay branch expenses. This is in the name of "The Witt Company, Special Account." Checks drawn on the account require the manager's signature or the signature of the Treasurer of the company. Bank statements and cancelled checks are returned by the bank to the manager, who retains them in his files after making the reconciliation. Reports of disbursements are prepared by the manager and submitted to the home office on scheduled dates.

9 [8]

In a customary annual examination of the accounts of a manufacturing company, the President of the corporation has requested that you confine your work to the balance sheet at the year end and certify to the balance sheet, only. He contends that if the balance sheet is verified, and you have previously verified the balnace sheet at the close of the preceding year, then the net income for the year must be the difference. Hence, he contends, there is no necessity for spending the time to check the income statement.

What reasons would you advance for the desirability of checking the income and expense account in sufficient detail to permit certification thereof? (Disregard any income-tax consideration).

PRACTICAL ACCOUNTING — Part I

Wednesday, May 16, 1951—1.30 to 6 p. m., only

Solve all problems. Consider technic and neatness as carefully as mathematics.

1 [10]

The City Wholesale Company lost its entire inventory of merchandise and its furniture and fixtures by fire early in January, 1951, before completing the physical inventory which was being taken as of December 31, 1950. The following information was taken from the books of the company as of December 31, 1948, 1949 and 1950:

	December 31, 1948	*December 31, 1949*	*December 31, 1950*
Inventory, January 1	$ 35,304	$ 42,380	$ 45,755
Purchases	160,842	164,426	174,433
Purchase returns and allowances	9,163	8,021	10,015
Sales	185,904	196,603	203,317
Sales returns and allowances	3,325	2,402	2,212
Wages	15,271	17,743	18,356
Salaries	7,500	8,000	9,000
Taxes other than income	2,647	3,732	3,648
Rent	4,800	5,400	5,400
Insurance	915	967	982
Light, heat and water	1,012	1,134	1,271
Advertising	2,875	4,250	2,680
Interest expense	3,365	2,755	3,020
Depreciation expense	1,125	1,255	1,280
Furniture and fixtures, net of depreciation	9,150	10,065	10,570
Miscellaneous expenses	6,327	6,634	6,897

a From the above information, you are to estimate the book amount of the inventory destroyed by the fire assuming that there were no transactions after December 31, 1950.

b Based on such estimate and the book value of furniture and fixtures, determine the amount due from each insurance company in settlement of the total loss of the assets under the following concurrent policies, each containing the 80% co-insurance clause:

	Policy on Stock	*Policy on Furniture*
A Company	$20,000	$2,000
B Company	15,000	3,000
L and D Company	10,000	3,000

c Assuming that the fire loss was 50% of the amounts used in *b*, determine the amount due from each company under the same three policies.

2 [5]

There are ten men working as a group on a particular manufacturing project. When the weekly production of the group exceeds a standard number of pieces per hour, each man in the group is paid a bonus for the excess production in addition to his wages at hourly rates. The amount of the bonus is computed by first determining the percentage by which the group's production exceeds the standard. One-half of this percentage is then applied to a wage rate of $1.25 to determine an hourly bonus rate. Each man in the group is paid, as a bonus, this bonus rate applied to his total hours worked during the week. The standard rate of production before a bonus can be earned is two hundred pieces per hour.

On the basis of the production record stated below, compute:

a the rate and amount of bonus for the week.

b the total wages of Allen, who worked forty hours at a base rate of $1.00 per hour, and of Knoll, who worked thirty-nine and one-half hours at a base rate of $1.50 per hour.

PRODUCTION RECORD

	Hours Worked	*Production*
Monday	72	17,680
Tuesday	72	17,348
Wednesday	72	18,000
Thursday	72	18,560
Friday	71.5	17,888
Saturday	40	9,600
	399.5	99,076

3 [15]

The D. P. Manufacturing Company produces one principal product. The income from sales of this product for the year 1950 is expected to be $200,000. Cost of goods sold will be as follows:

materials used	$40,000
direct labor	60,000
fixed overhead	20,000
variable overhead	30,000

The company realizes that it is facing rising costs and in December is attempting to plan its operations for the year 1951. It is believed that if the product is not redesigned the following results will be obtained:

Material prices will average 5% higher and rates for direct labor will average 10% higher. Variable overhead will vary in proportion to direct labor costs. If sale price is increased to produce the same rate of gross profit as the 1950 rate, there will be a 10% decrease in the number of units sold in 1951.

If the product is redesigned according to suggestions offered by the sales manager, it is expected that a 10% increase can be obtained in the number of units sold with a 15% increase in sale price per unit. However, change in the product would involve several changes in cost.

A different grade of material would be used but 10% more of it would be required for each unit. The price of this proposed grade of material has averaged 5% below the price of the material now being used and that 5% difference in price is expected to continue for the year 1951. Redesign would permit a change in processing method enabling the company to use less skilled workmen. It is believed that the average pay rate for 1951 would be 10% below the average for 1950 due to that change. However, about 20% more labor per unit would be required than was needed in 1950. Variable overhead is incurred directly in relation to production. It is expected to increase 10% because of price changes and to increase an additional amount in proportion to the change in labor hours.

Assuming the accuracy of these estimates, you are to prepare statements showing the prospective gross profit if:

a the same product is continued for 1951.

b the product is redesigned for 1951.

4 [20]

You were given the following trial balances of the Harlan Company. The trial balance as of December 31, 1950, was taken on a gross basis; that is, the total of the debits and of the credits in each of the ledger accounts, including any balance from the after-closing trial balance at June 30, 1950, rather than the final balance, has been included. You are advised that the company records disbursements for expense items through liability accounts prior to making payment.

The books are not available. Since the trial balance is out of balance by $270, shown as Unlocated difference, you attempt to locate the probable source of this difference. You are told that cash in bank of $28,044 has been verified.

You are to reconstruct the ledger accounts as they probably appear. Record the transactions for the period in journal form and in skeleton ledger accounts keyed to the journal entries. You need not prepare financial statements, but you should state where you think the error occurred in the books and give reasons to support your conclusion.

THE HARLAN COMPANY
TRIAL BALANNCES

Account	*June 30, 1950*		*December 31, 1950*	
Cash in bank	$ 21,849		$ 275,016	$ 246,972
Investments	30,500		40,712	5,000
Accounts receivable	47,420		301,425	248,979
Merchandise inventory	55,542		208,856	153,495
Office furniture & fixtures	8,663		11,164	635
Allowance for depreciation		$ 4,967	176	5,940
Bank loans		30,000	10,000	30,000
Accounts payable		15,879	211,658	233,986
Accrued income tax		7,350	5,658	11,050
Capital stock		50,000		50,000
Earned surplus		55,778	10,000	55,778
Sales			481	254,005
Cost of sales			151,914	
Executive salaries			15,500	
Other administrative expense			21,567	
Selling expense			25,348	
Bad debt losses			665	
Writedown of obsolete merchandise			1,025	
Profit on sale of investment				168
Loss on sale of fixtures			23	
Interest expense			850	
Income tax expense			3,700	
Unlocated difference			270	
	$163,974	$163,974	$1,296,008	$1,296,008

PRACTICAL ACCOUNTING — Part II

Thursday, May 17, 1951—1.30 to 6 p. m., only

Solve problems 1 and 2 and either problem 3 or problem 4. Working papers (but not statements) may be in pencil. All other papers are to be written in ink. Consider technic and neatness as carefully as mathematics.

1 [10]

The following questions relate to federal income taxes. No reasons need be given to support your answer. Your grade will be based entirely on the number of correct answers you submit.

a The following statements are to be answered by deciding whether the statement is essentially true or false. If the statement is true, enter (a) on your answer sheet; if the statement is false, enter (b) on your answer sheet.

(1) An infant who has $800 gross income can not be claimed as a dependent by his parent. (a) True (b) False

(2) Entertainment costs incurred by a salesman, not reimbursable by his employer, are deductible by the salesman. (a) True (b) False

(3) If a landlord receives $5,000 rental in 1950, covering rent for the five years ended December 31, 1954, $1,000 is included in gross income for the year 1950. (a) True (b) False

(4) Bad debt recoveries subsequent to year of write-off may be excluded from gross income of the year in which recoveries are made if no tax benefit resulted from the write-off. (a) True (b) False

(5) Fees received for serving on a jury are includable as taxable income. (a) True (b) False

(6) Compensation received by a minor for services rendered is included in the gross income of the parent. (a) True (b) False

(7) Resident aliens are taxed on income from sources outside the United States. (a) True (b) False

(8) Life-insurance proceeds received by widow at death of spouse need not be included in her taxable income. (a) True (b) False

(9) Nonresident aliens not engaged in business in the United States are taxed on cash dividends received from domestic corporations. (a) True (b) False

(10) Contributions made to a close family friend by an individual to keep him off relief are deductible by the contributor, if not in excess of 15% of adjusted gross income. (a) True (b) False

b Enter on your answer sheet the letter which identifies the correct amount for *each* of the following situations.

(1) Joseph Green who was 68 years old filed a joint return for 1950 with his wife, Martha Green, who attained the age of 65 on July 27, 1950. Mrs. Green is blind. What exemption may be claimed in the return? (a) $1,200 (b) $1,800 (c) $2,400 (d) $3,000

(2) In a joint return filed for 1950, Mr. and Mrs. Brown reported net income of $15,000 before giving effect to security transactions. During the year, they sold the following securities which had been acquired in 1948.

Detail	*Cost 1948*	*Selling Price 1950*	*Profit or Loss*
Mr. Brown:			
100 shares "O" stock	$2,000	$2,700	$ 700
Mrs. Brown:			
300 shares "Y" stock.....	5,900	2,000	(3,900)

How much of the loss may be applied against the net income of $13,000? (a) $1,000 (b) $1,600 (c) $2,000 (d) $3,200

(3) James Anderson, who reports on a cash basis, paid a certified public accountant the following amounts during 1950:

For preparation of federal income-tax return for 1949..... $200
For contesting a federal income-tax deficiency for 1948.... 600

What amount may be deducted in his 1950 tax return? (a) $800 (b) $600 (c) $200 (d) 0

(4) James Johnson's return for 1950 reports adjusted gross income of $20,000. The only charitable contribution he made in 1950 was a gift to the Museum of Art, New York, of a valuable painting which he had purchased in 1925 for $1,600 and which had a value of $3,500 at date of gift . What amount may he deduct as a charitable contribution? (a) $3,500 (b) $3,000 (c) $1,600 (d)0

(5) Jerome White (single) reports adjusted gross income for 1950 of $11,200. The only allowable deductions shown by his records are as follows:

Interest	$200
State taxes	300
Contributions	100
Total	$600

In filing his 1950 return, what is the maximum amount he may claim as a deduction? (a) $600 (b) $1,000 (c) $1,120

(6) James McMahon who owns 80% of the outstanding stock of the McMahon Furniture Co. sold 100 shares of stock of the General Lumber Co., which cost him $9,000 in 1947, to the McMahon Furniture Co. for $6,000 in June, 1950. The furniture company sold the 100 shares of lumber company stock to outside interests for $7,000 in August, 1950.

(*A*) Assuming no other capital asset transactions, James McMahon is permitted to deduct on his tax return for the year 1950, in connection with the sale of General Lumber Co. stock, (a) $3,000 (b) $1,500 (c) $1,000 (d) 0

(*B*) Assuming no other capital asset transactions, the furniture company, in connection with the sale of General Lumber Co. stock, has a taxable gain of (a) 0 (b) $500 (c) $1,000

c James O'Day, U. S. Citizen, residing in Chicago, Illinois, reporting on a cash basis for the calendar year, received the following income items and paid the following expense items during 1950. For *each* of the items listed, you are to show by the appropriate letter whether the item is (a) taxable (b) nontaxable (c) allowable deduction (d) unallowable deduction

Income Items

1 accident insurance proceeds
2 bequests and devises
3 interest on municipal bonds
4 executor's fees
5 gains on sales of city and state bonds
6 gambling winnings
7 prizes won at contests, exhibitions, etc.
8 U. S. war veterans bonus

Expense Items

9 automobile upkeep expense, car used exclusively for pleasure
10 expense of transporataion from suburban home to office
11 part of payment to Cooperative Apartment Corporation covering taxes and interest
12 dues paid social club for personal use only
13 periodic alimony paid to divorced wife by decree of court
14 cost of safe deposit box used to store securities
15 dues paid to labor union

2 [25]

The assets shown on the balance sheets at September 30, 1950, of three summer resorts on Waverly Lake are shown below. The appraisal data opposite the book values for land and depreciable assets summarize an independent appraisal made in September, 1950, as a basis for negotiations to combine the three resorts under one management. The appraisal was made on the basis of reproduction cost less depreciation.

Description	*Book Value*	*Appraised Value (Reproduction Cost Less Depreciation)*
Assets of Waverly Hotel Co.		
Current	$15,000	
Land	5,000	$ 10,000
Hotel building	12,500	38,000
Boathouse	600	2,000
Kitchen equipment	1,000	1,000
Other equipment	4,000	29,000
Total	$38,100	$ 80,000

Assets of Rustic Camps
(Orville Johnsen, Proprietor)

Current	$ 3,000	
Land	1,000	$ 1,500
Lodge	4,000	9,500
Boathouse	600	700
Kitchen equipment	2,500	2,500
Other equipment	1,000	800
Total	$12,100	$ 15,000

Assets of Lakeview Cottages
(Burgess & Crayton, A Partnership)

Current	$ 6,800	
Land	3,000	$ 1,600
Lodge	8,000	9,400
Cottages	15,000	32,000
Lodge kitchen equipment	2,000	2,000
Other equipment	3,500	5,000
Total	$38,300	$ 50,000
Total appraised value of land and depreciable assets		$145,000

Operating statements for the year ended September 30, 1950, are as follows:

	Waverly Hotel	*Rustic Camps*	*Lakeview Cottages*
Revenue	$17,281	$13,698	$8,740
Deduct:			
Officers' salaries	$ 3,600		
Partners' drawings			$5,500
Depreciation	1,590	$ 850	2,300
Interest on notes	600		
Other expenses	8,112	5,224	1,868
Total	$13,902	$ 6,074	$9,668
Net income (loss)	$ 3,379	$ 7,624	($ 928)

The hotel's clientele has been declining in recent years so Mr. Holt, the principal stockholder and manager, decided to retire. The Rustic Camp's profit is attributable to Mr. Johnsen's facility with people and knack for organized recreation. Burgess and Crayton provide light-housekeeping cottages and serve dinner in the lodge, but provide no organized recreation.

The three businesses agree to combine by organizing a new corporation, Waverly Resorts, Inc. This corporation is to have authorized capital of 2,000 shares of 5% cumulative preferred stock of $100 par value and 1,000 shares of no-par common stock. The new corporation will take over the land and depreciable assets of the three businesses. It will also take over from the hotel at $10,000 and from the partnership at $5,000 certain assets classed as current, but which are carried on their books at $10,500 and $4,800, respectively. All liabilities are to be paid off by the separate businesses and all other current assets retained by them.

In exchange for the assets acquired, the corporation is to issue to the Hotel Company $50,000 of first-mortgage 4%-bonds and preferred stock having $32,500 par value. Rustic Camps is to receive $25,000 of preferred stock and Lakeview Cottages is to receive $55,000 of preferred stock. The differences between the appraisal values of the properties taken over and the bonds and stock issued are to adjust for the low income earned on the hotel property and the high income which Mr. Johnsen has been receiving from his camps as a result of his ability to attract patronage.

Common stock is all to be issued and divided to the nearest share among the three businesses in the ratio of their net operating profits for the year ended September 30, 1950, adjusted as follows:

As an approximtaion of correct depreciation, the depreciation charges for the past year are to be recomputed. In recomputing, use rates of 4% per annum for building and 10% for equipment applied to the September 30, 1950, appraised values. The new corporation will use the 10% and 4% annual rates, applied to the balances in the asset accounts at the first of each quarter-year period.

As a result of a specific request for information as to the adequacy of past maintenance, the appraiser reported that maintenance on the hotel had been inadequate over the past 10 years to the extent of approximaely $500 per year. Adjustment is to be made for the annual deficiency.

It is also agreed that for the purpose of restating profits, each business should have $3,000 a year charged as the reasonable value of the services of the officers or owners.

The businesses were combined on October 1, 1950, as planned. Transactions for the three months ended December 31, 1950, are summarized below:

Received $6,500 from guests.

Paid $1,800 to Tom and Lee Wilson whose time was spent as follows: One-half installing equipment to convert the Rustic Camp's Lodge to a bar and dance pavilion; one-third moving the camp's boathouse adjacent to the hotel boathouse; and one-sixth moving wooden floors for tents from the camps to a location near the cottages.

Equipment for the pavilion was purchased for $1,500 of which $1,200 was paid.

The principal maintenance work needed on the hotel was done in December at a cost of $4,500. Payment for this work was made by issuing a 12-month note.

Three hundred dollars appraised value of kitchen equipment in the lodge was moved to the hotel and the remaing $1,700 of equipment was sold for $550.

Orville Johnsen's monthly salary of $400 was paid for October and November.

Other expenses amounted to $3,000 of which $2,750 was paid.

You are to prepare a worksheet for the Waverly Resorts, Inc. with columns showing the acquisition of the assets on October 1, 1950; the transactions from October 1 to December 31; the Income Statement figures for the three months ended December 31 and Balance-Sheet figures for December 31, 1950. In a separate schedule you are to show the distribution of the common stock among the three business units. Give an explanation and justification for your treatment of any transaction where you consider the treatment to be debatable.

Solve either problem 3 or problem 4.

3 [15]

The Town of Big Springs had not been operating a public library prior to October 1, 1950, James Jones died, having made a valid will which provided for the gift of his residence and various securities to the town for the establishment and operation of a free public library. The gift was accepted by the town. The library funds and operation were placed under the control of trustees. The terms of the gift provided that not in excess of $5,000 of the principal of the fund could be used for the purchase of equipment, building rearrangement, and purchase of such standard library reference books as, in the opinion of the trustees, were needed for starting the library. Except for this $5,000, the principal of the fund is to be invested and the income therefrom used to operate the library in accordance with appropriations made by the trustees.

The property received from the estate by the trustees was as follows:

Description	*Face or Par*	*Appraised Value*
Residence of James Jones:		
Land		$ 2,500
Building (25-year estimated life)		20,000
Bonds:		
AB Company	$34,000	32,000
C & D Company	10,000	11,200
D & G Company	20,000	20,000
Stocks:		
M Company, 6% preferred	12,000	12,600
S Company, 5% preferred	10,000	9,600
K Company, common (300 shares)	No par	12,900
GF Company (200 shares)	4,000	14,500

The following events occurred in connection with the library operations up to June 30, 1951:

a 100 shares of GF Company stock were sold on November 17 for $6,875.

b Cash payments were made for: (*a*) Alteration of the house—$1,310, (*b*) General reference books—$725, (*c*) Equipment having an estimated life of ten years—$2,180. The trustees state that these amounts are to be charged to principal under the applicable provision of the gift.

c The library started operation on January 1, 1951. The trustees adopted the following budget for the year ended December 31, 1951:

Estimated income from investment	$5,000
Estimated income from fines, etc.	200
Appropriations for salaries	3,600
Appropriation for subscriptions	300
Appropriation for purchase of books	800
Appropriation for utilities, supplies, etc.	400

d The following cash receipts were reported during the six months to June 30, 1951:

Sale of C and D Company bonds including accrued interest of $80	$11,550
Interest and dividends	3,100
Fines	20
Gift for purchase of books	200
Total	$14,870

e The following cash payments were made during the six months to June 30, 1951:

Purchase of 100 shares of no-par common stock of L and M Company including commission and tax cost of $42.50	$ 9,655
Payment of salaries	1,500
Payment of property taxes applicable to the year ended December 31, 1950, based on an assessment as of June 30, 1950	200
Purchase of books	900
Magazine subscriptions	230
Supplies and other expense	260
Total	$12,745

f On June 30, 1951, there were miscellaneous expenses unpaid, but accrued, amounting to $90. Also there were outstanding purchase orders for books in the amount of $70.

Assuming the town records budgetary accounts, prepare all statements necessary to show results of operation to June 30, 1951, and the financial position of the library as of June 30, 1951. Where alternate treatment of an item is possible, explain the alternate treatment and state the justification for your treatment.

4 [15]

A, B and C decided to practice law together from January 1, 1948. They entered into an agreement under which they shared profits and losses in the proportion of 50%, 25% and 25%, respectively, and agreed to contribute $50,000 in cash in these same proportions to provide working capital. They decided to keep their books on a cash basis.

On January 1, 1949, B died and the remaining partners agreed to admit D, giving him a 20% share in the profits with a minimum guarantee of $10,000 per year whether operations were profitable or not. A and C had percentages of 45 and 35, respectively. This partnership was of one year's duration and at the end of this period C decided to retire but permitted the use of his name in future partnerships subject to the payment to him of $5,000 per annum to be treated as an expense of the partnership.

As of January 1, 1950, a partnership was formed in which C's name was utilized in accordance with his proposal and to which E was admitted. The partners' interests in this partnership were as follows: A—55%, D—30%, E—15%.

Since there were no substantial accruals at the end of the year, disbursements for expenses made during any one period were treated as expenses of the then current partnership. These disbursements were $70,000 in 1948, $80,000 in 1949 and $90,000 in 1950.

Receipts of fees were as follows:

	Earned By Partnership		
	No. 1	*No. 2*	*No. 3*
1948	$ 80,000		
1949	145,000	$40,000	
1950		50,000	$70,000

Each new partnership agreement provided for the newly created partnership to purchase from the old partnership the $50,000 capital originally paid in by A, B and C.

The agreements also provided that the partners should bear the cost of acquisition of this amount in the proportion in which they shared profits (and losses). However, it was agreed that an incoming partner, or one acquiring an increased percentage, need not make his contribution in cash immediately but could have the same charged to his drawing account. All such partners availed themselves of this privilege. Partners selling all or a part of their interest in capital are credited through their drawing accounts and immediately withdraw the amount of such credit. In addition to drawings made under this agreement, the partners or their heirs made cash drawings as follows:

	A	*B*	*C*	*D*	*E*
1948	$10,500	$27,750	$13,750		
1949	40,000	4,750	5,000	$7,000	
1950	10,000	5,000	15,000	2,500	$5,000

You are asked to prepare statements showing the details of transactions in the partners' drawing accounts and capital accounts for each of the years involved. The partners wish you to prepare these accounts in such form that the balance at the end of each year which was available for withdrawal by each partner is shown in that partner's drawing account. They wish their capital accounts to reflect only the $50,000 original investment.

The Excess Profits Tax Exchange

(Continued from page 566)

"Incongruity #2 appears at line 30 of page 1 of Schedule EP. This item, as you know, requires the recomputation of the normal and surtax based on excess profits net income. The Regulations, as well as the tax return itself, call for this computation to be made based on the *tax year of the corporation.* While the Code would seem to approve such a determination, there nevertheless is an inequity inherent in this determination. It would appear that a more equitable treatment would be to compute the normal and surtax on the excess profits net income *at the rates prescribed subsequent to June 30, 1950, regardless of the tax year of the taxpayer.*

"The latter incongruity was pointed up to me in a situation which might be illustrated as follows:

"Assuming that a corporation with a fiscal year ended March 31, 1951, enjoyed net income (income tax as well as excess profits tax net income) of $400,000. A preliminary computation indicated that one-quarter (*Note:* fractions of a year are taken on a monthly basis instead of a daily basis throughout these computations) of the net income or $100,000 should be taxed at 38% and the remaining three-quarters, or $300,000, should be taxed at 62% (I should add that the 62% limit is applicable). The tax would thus be $38,000 on the first part and $186,000 on the second part, or a total tax of $224,000. The computation, following the presentation on the return, would produce the following result:

"The income tax would be $174,875 (¼ of $152,000—the tax on $400,000 on pre-June 30, 1950, rates plus ¾ of $182,500, the tax at post-June 30, 1950 rates). The excess profits tax would be computed as follows:

62% of $400,000 equals.....	$248,000
Less: Income tax (as above).	174,875
Net Excess Profits Tax.....	$ 73,125
¾ thereof, for period subsequent to 6/30/50	$ 54,843.75
Total tax ($174,875 + $54,843.75)	$229,718.75

"Should not the computation be as follows in order to produce the equitable result indicated above (namely, $224,000):

Excess Profits Tax—62% of $400,000	$248,000
Less: Income tax at *post-6/30/50 rates*	182,500
Net Excess Profits Tax.....	$ 65,500
¾ thereof, for period subsequent to 6/30/50	$ 49,125
Total tax ($174,875 + $49,125).	$224,000

"In other words, inasmuch as the excess profits tax is *first uniformly computed on the assumption that the entire income is earned subsequent to June 30, 1950,* should not the law be consistent and provide that in the first instance the normal and surtax be computed on the basis of the tax rates prevailing subsequent to June 30, 1950?"

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